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THE SEC'S INVESTIGATION OF THOMAS REED

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

THE SEC'S INVESTIGATION OF THOMAS REED

MARCH 22, 1983

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THE SEC'S INVESTIGATION OF THOMAS REED

TUESDAY, MARCH 22, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, D.C.

The subcommittee met at 1 p.m. in room SD-538 of the Dirksen Senate Office Building, Alfonse M. D'Amato (chairman of the subcommittee) presiding.

Present: Senators D'Amato, Proxmire, and Riegle.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO [presiding]. The Subcommittee on Securities will come to order.

This afternoon we're holding a hearing, and I would like to welcome Chairman Shad and the Commissioners: Mr. Evans, Ms. Thomas, and Mr. Longstreth, and Mr. Fedders, director of the SEC's Division of Enforcement.

In recent weeks it has become a matter of public perception, through countless newspaper articles, and TV news programs with respect to the Securities and Exchange Commission's treatment of Mr. Thomas Reed.

Mr. Reed is alleged to have traded securities options—by use of what is generally termed "inside trading information" as a result of his father's position on the board of a company, Amax. When another corporation indicated its desire to acquire Amax, Reed was able, with an investment of some $3,125 in a period of 48 hours, to see the options he purchased rise in value, so that approximately $429,000 inured to his benefit. The matter is presently under investigation in the U.S. Attorney's Office for Criminal Action in the Southern District.

Apparently—after having initially purchased the options for his own account, Mr. Reed thought better of it, and he became analogous to someone who I used to watch for a number of years on television—on a program called "The Millionaire." In that program Michael Anthony would go around and make anonymous gifts of $1 million. John Beresford Tipton was the person who was responsible for the $1 million. I waited, by the way, for a long time as a youngster hoping that Michael Anthony would some day call on me.

If one could believe the record, after having reviewed this case and Mr. Reed's testimony, and if it is credible and if it is substantiated, then indeed we have found a modern-day millionaire in the presence of Mr. Reed, as he has taken the place of John Beresford Tipton.

What a wonderfully magnanimous person to so desperately work the telephones, calling his father in Barbados and thereafter his secretary, thereafter his broker, and thereafter having experienced this marvelous upsurge in these options, to then decide to be so charitable and designate people to benefit by his wonderful good fortune.

He certainly did go to great lengths—if one can believe Mr. Reed, he did this for the people, and he wanted to enrich them. Some were elderly, some were sick, some were in need of money, and he certainly did take a great chance also because of the fact that it is a violation of law when you sign someone's name and you break all kinds of rules and regulations, in using the information that one would have obtained in making this investment.

I think that it stretches beyond credibility and the good will of people to believe that this was some fortuitous investment on the part of Mr. Reed, that he did not indeed possess inside information that came as a result of his father's being on the board of directors, that the series of phone calls that were made to Barbados and from Washington, then to California—as early as 5:20-some-odd in the morning those calls were being received in California—that this was his usual way of conducting himself.

We certainly have a unique individual. I don't know what could be revealed since, we've had the cooperation of the SEC in reviewing this file, but if there are circumstances and facts that I am unaware of, that would put Mr. Reed in a better light, I'd like to hear them.

The fact is, though, barring any unforeseen factual information with respect to Mr. Reed, and what has taken place, and what has occasioned this, I think he should now perform a true act of generosity, something that's overdue and resign his position, as I think it's totally unconscionable to have a person who would have undertaken this, to stay in the high position that he is in.

That is one Senator's opinion, this particular Senator.

Now, before we undertake or give our Commissioners—and we thank them for being here—the opportunity of giving us an overview and answering some of our questions, I know my colleague, Senator Proxmire, would like to make a statement.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Thank you very much, Mr. Chairman.

Mr. Chairman, first, I'd like to say that I'm delighted you called this hearing because I've said again and again—and I want to say it once more: I think the SEC is the best agency in Washington. I think it's been that throughout the years.

By best I don't just mean taking an optimum statement out of the air, it's the best in its competence, its honesty, its effectiveness. We have capital markets that are the envy of the world. One reason is because we have a thriving rich economy, but a more important reason, to me, is that we have its absolute integrity so well enforced by the SEC.

People can invest in our markets and know that what they're buying is what it's purported to be. We insist on disclosure and

what we're talking about here, goes right to the heart of the integrity of the SEC.

So I think calling these hearings is most appropriate. As the chairman has said, this is the Thomas Reed affair.

Certainly the handling of this case, as the SEC, does bear some scrutiny. At the same time I hope we do not lose sight of the larger issue, and that is, why was Mr. Reed appointed to a sensitive national security post when the White House was fully aware of his questionable securities dealings?

His appointment raises serious questions not only about the procedures of the White House but more fundamentally, about the attitude of this administration, the Reagan administration, concerning our Nation's securities laws and what is, and is not appropriate ethical behavior.

One might argue that the manner of Mr. Reed's appointment is the subject for the Armed Services Committee, Foreign Relations Committee, and is not within the Banking Committee's jurisdiction.

I think you can make a strong argument that way, but this committee does have a legitimate interest in seeing that our securities laws are accorded the respect and support they deserve throughout the Government.

Congress made a serious ethical judgment when it prohibited insider trading. The judgment was absolutely summed up by the present head of the SEC Enforcement's Division, who is testifing today, John Fedders, when he said and I quote: "Anyone who engages in insider trading is clearly a thief."

And whatever criticisms we might level against the details of the final settlement of the *Reed* case, the SEC's staff and its five Commissioners obviously believed Mr. Reed had engaged in insider trading.

In Mr. Fedders' words, therefore, Mr. Reed was therefore clearly a thief.

So while we have one arm of the Government concluding a man is a thief, we have another arm appointing him to a sensitive national security post.

Mr. Reed was appointed as a temporary consultant to the National Security Council in January 1982 shortly after the SEC settlement. At that time well-placed administration officials, as they were called in the press, indicated that they were testing public reaction before hiring Reed as a permanent staff member.

What was regarded as thievery at the SEC was merely a matter of public relations for well-placed administration officials.

Mr. Chairman, if insider trading is regarded as simply a public relations matter at the highest levels of our Government, we're in serious trouble. That attitude can only undermine respect for our securities laws and weaken their effective enforcement.

Thus, I think all aspects of the Reed affair are clearly relevant to this committee. We need to determine whether the securities laws are given the proper respect they deserve, not only within the SEC but throughout the entire Federal Government as well.

Mr. Chairman, as you know, I have written you about these hearings along with other members of the subcommittee. I respectfully renew our request that you expand the scope of these hear-

ings and call National Security Adviser William Clark and Special Assistant Mr. Richard Morris to testify on the circumstances surrounding Mr. Reed's appointment and what they understood the SEC to tell them about Mr. Reed at the time.

They decided Mr. Reed would be appointed. Thank you.

Senator D'AMATO. Chairman Shad.

TESTIMONY OF JOHN S. R. SHAD, CHAIRMAN, THE SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY COMMISSIONERS JOHN R. EVANS, BARBARA S. THOMAS, AND BEVIS LONGSTRETH; AND JOHN F. FEDDERS, DIRECTOR, DIVISION OF ENFORCEMENT, THEODORE A. LEVINE, GARY G. LYNCH, L. DUANE CHEEK; AND DANIEL L. GOELZER, GENERAL COUNSEL

Chairman SHAD. Chairman D'Amato and Senator Proxmire, I have an opening statement which I hope will respond to many of the questions that have been raised—I'm sure not all of them.

As requested, with me today, here are Commissioners Evans, Thomas, and Longstreth; four members of the Enforcement Division who conducted the Mr. Reed investigation; John Fedders, the Director; Theodore Levine, Gary Lynch, and Duane Cheek, as well as the Commission's General Counsel, Daniel Goelzer.

The fifth commissioner, James Treadway, was not a member of the Commission when the Mr. Reed matter was considered.

The Commission has previously provided this subcommittee and two house subcommittees with copies of the Commission's documents on this case.

ANNOUNCEMENT OF MERGER PROPOSAL

The following is a brief overview. All of the events in this case took place in 1981. On March 5, 1981, Amax, Inc. publicly announced a merger proposal from Standard Oil of California, referred to as Socal, at a price of $78.50 per Amax share. Amax was then trading at $38 per share. The total consideration was approximately $4 billion. Amax common stock was traded on the New York and other stock exchanges, and options on this common stock are traded on the American Stock Exchange.

On the day of the announcement, March 5, 1981, the staffs of the American Stock Exchange and the SEC noted the large volume of the transactions in Amax options prior to the announcement.

Within 24 hours the American Stock Exchange's staff informed the Commission's Enforcement Staff that Thomas Reed was one of the purchasers. The staff determined that his father was an Amax director.

Within a week the Commission issued a formal order of investigation that gave the staff subpoena power. During the investigation the staff learned, among other things that on February 5 certain Amax directors, including Thomas Reed's father, were informed of a January 26th merger overture from the Socal chairman.

On or about February 25 of that year, 1981, Thomas Reed's father knew that a special Amax board meeting, called on March 5, was at the request of Socal. On March 4, following telephone conversations with his father, Thomas Reed called his broker and pur-

chased call options on 50,000 Amax shares exercisable at $50 per share on or before March 21.

Since the stock was then trading at $38, it would have had to rise above $50 within 12 trading days for him to be able to exercise the options at a profit. He paid $3,000 for the options and sold them 2 days later at a $427,000 profit.

Despite contrary evidence—and I think that's an important statement—despite contrary evidence, the SEC staff concluded that there was substantial circumstantial evidence that Thomas Reed had acted on material, nonpublic information.

On November 3, following a discussion of the strengths and weaknesses of the circumstantial evidence and the legal theories on which the case could be brought, the Commission unanimously authorized the staff to file a civil action against Thomas Reed.

As a result of settlement negotiations, the staff obtained a court order prohibiting future inside trading by Thomas Reed and requiring disgorgement of the $427,000 profit.

ALLEGED INSIDER TRADING

The Commission unanimously approved the proposed settlement on December 21. On December 23, the Commission's complaint, which alleged insider trading, was filed and the order entered in the U.S. District Court for the Southern District of New York.

Violation of the order is punishable by criminal contempt. The following is an amplification of the facts of the case: In the course of its investigation, the SEC staff obtained documents from over 40 persons, brokers and others, and took testimony from over 30 persons including Thomas Reed, 8 employees of his broker, his secretary, his father, and 4 other officers or directors of Amax, the father's broker and other option purchasers, their relatives and brokers.

The staff identified three purchases of Amax options by Thomas Reed on January 30, February 2, and March 4. While Thomas Reed had substantial holdings in Amax common stock for a number of years, his first purchases of Amax call options occurred on January 30 and February 2.

He paid $40,000 for options to purchase 50,000 Amax shares on or before March 21. Although there had been discussions between the chairmen of Socal and Amax on January 26 shortly before his purchases, the staff was not able to establish that Thomas Reed knew of these discussions.

On January 26 the Socal chairman told the Amax chairman that he would consider recommending to the Socal board a price in the $70 range for all of Amax's outstanding common stock, but that he had not yet discussed this with his board. The Amax chairman said at least $90 per share would be required before he would present it to his board.

The Socal chairman responded that Socal would never offer that much. Four days later on January 30 and again on February 2, Thomas Reed made his initial purchases of the Amax options.

On February 5, the Amax chairman informed the Amax directors, except the three Socal representatives on Amax's board, of his

January 26 conversation with the Socal chairman and the position each of them had taken.

Thomas Reed's father testified that he did not learn of the January 26 conversation until that day, February 5.

Although the timing of Thomas Reed's option purchases shortly after the January 26 conversation between the two chairmen and before the February 5 Amax board meeting raises questions, the staff was unable to establish that Mr. Reed was aware of the merger negotiations prior to his purchases. In addition, given the nature and conclusion of the conversation between the two chairmen, even had he known, the staff had questions concerning the materiality of the conversation.

However, the staff did determine that there was substantial circumstantial evidence that Thomas Reed had received material inside information prior to his March 4 transaction.

On the evening of February 8 and the morning of February 9, 3 days after his father had learned at the Amax board meeting of Socal's interest in a merger, Thomas Reed testified that they discussed certain business matters concerning Amax, including the fact that Socal owned an interest in Amax and his father's negative views of a greater involvement by Socal in Amex.

On or before February 25, his father was called in Barbados by the Amax corporate secretary and asked if he could return later that week for a special Amax board meeting called at the request of Socal.

Later that day, he was called and told that the special meeting would be held on March 5. Thomas Reed's father testified that, on March 2, he discussed with his son an investment in another corporation that he was considering.

According to the testimony of both, on March 4, they had two telephone conversations. At 8:13 a.m., eastern standard time, they again discussed an investment in another corporation. And at 9:39 a.m., they discussed plans to meet in Connecticut on March 5.

Three minutes later, Thomas Reed called his broker in California to purchase coal options on 50,000 Amax shares.

After three unsuccessful attempts, at 9:42, 9:57, and 10:08 a.m, eastern standard time, he reached his broker at 11:06 a.m. and placed the order.

It was executed that morning, March 4, at a cost of approximately $3,000.

Following the March 5 announcement, Reed sold the options on March 6, at a $427,000 profit. The proceeds were credited to the accounts of eight of his employees, relatives, and close friends.

On March 6, he instructed his secretary to have five of the recipients, including herself, open accounts at his broker, which she did.

Also on March 6, he filled out new account and options forms for two of the other recipients, and signed their names.

He created certain of the information and backdated the forms to March 2. He also instructed a business associate, the eighth recipient, to backdate her new account papers to March 4.

The staff's conclusion that Thomas Reed possessed material nonpublic information prior to his March 4 purchases was based on, among other things, the proximity of his purchases, and conversations with his father, and the fact that the options could be exer-

cised at a profit only if the stock rose from 38 to over 50 before the options expired, in less than 3 weeks.

However, the staff was unable to discover any direct evidence that he had received inside information. He cited several facts rebutting the inference of wrongdoing. Both he and his father denied under oath that any inside information had been communicated during any of their conversations.

In addition, testimony was provided that he evidenced his intention to purchase Amax options before March 4. A business associate testified that he told her on March 1 that he was contemplating purchasing some Amax options.

His secretary also testified that he told her on March 3 that he intended to buy some Amax options the next day as a gift for certain employees, relatives, and friends.

And he provided notes, charts, and graphs to support his testimony that his decision was made on March 3, and that he had been considering the purchase as early as February 27.

Given such evidence, the staff felt there was more than the usual risk in litigating a circumstantial case. Nevertheless, the Enforcement Division recommended to the Commission that a civil enforcement action be instituted against Thomas Reed alleging insider trading, specifically, violations of section 10(b) of the Securities Exchange Act, and rule 10b–5.

The staff also requested authority to negotiate a settlement prior to institution of the action. On November 3, the staff discussed with the Commission the strengths and weaknesses of the factual and legal case, including the litigation risks.

A memorandum from the Office of the General Counsel was also reviewed. It set forth legal theories supporting and opposing insider trading charges involving options, including a recent Federal District Court decision that a corporate insider, such as Mr. Reed's father, owed no duty to persons who traded in options on the corporation's stock.

Under the rationale of the 1980 U.S. Supreme Court decision in *United States* v. *Chiarella,* the Federal District Court concluded that trading on options on the basis of material nonpublic information did not violate rule 10b–5.

Despite the foregoing, the Office of the General Counsel indicated that several valid legal theories supported the proposition that Reed's father as an Amax director and his tippees were under a duty to disclose material information or to abstain from trading.

PROPOSED SETTLEMENT ORDER

At the November 3 meeting, the Commission authorized the action and the settlement negotiations. The staff proceeded to negotiate a settlement that included a court order prohibiting future insider trading by Thomas Reed, and requiring full disgorgement of the $427,000 profit on his March 4 purchases.

Violation of the order would subject him to criminal contempt, including the possibility of fine and imprisonment.

The proposed settlement order would also have required him to irrevocably place the $427,000 in an escrow account, under which the funds would be used first to satisfy judgments or settlements

relating to pending private litigation, based on his option transactions.

And second, to pay any Federal or State taxes that might be assessed as a result of the option transactions. The remainder would be contributed to a charity of his choice.

At a December 17 meeting, the Commission concluded that the proposed settlement order provided appropriate protection against future insider trading by Mr. Reed.

The Commission also examined whether a provision that had been included in prior settlements of insider trading cases, the use of the disgorged funds for charitable contributions, should continue to be acceptable, and whether respondents should be permitted to offset tax payments against disgorged funds.

The Commission concluded that Thomas Reed should not be permitted to use disgorged funds to pay related taxes, or to make unilateral charitable contributions.

Mr. Reed's initial settlement proposal also included his mitigating statement that the purchase was made without any attempt at concealment and in good faith.

It did not contain the statement that he was consenting without admitting or denying the allegations. The Commission rejected the mitigating language, but did not insist on inclusion of the "without admitting or denying" clause.

Typically, defendants request this clause in order to negate specifically the assumption that they are admitting the allegations.

The Commission has settled cases without the clause, but only with the clear understanding that the defendant will not deny the allegations in the complaint, which was the understanding in this case.

Mr. Reed agreed to the following provisions in the settlement order. The use of the escrow fund for tax purposes was deleted, and any funds that remained after payments to private litigants would be given to a charity agreed upon by the Commission and him with the Court's consent.

He also agreed to the deletion of the mitigating language, and the settlement papers were silent with respect to his position on the allegations.

On December 21, the Commission unanimously approved the revised settlement. On December 23, the complaint was filed in the U.S. District Court for the Southern District of New York.

After a presentation to Judge Morris Lasker, the court entered the order. On December 23, the Commission issued a press release announcing the filing and settlement. It was reported by the press the next day.

With regard to the possibility of referring this case to the Justice Department, during the initial stages of the investigation in March 1981, the staff confirmed that a Federal grand jury for the Northern District of California was also investigating this matter.

Subsequent to the settlement, in response to inquiries from the Criminal Division of the Department of Justice and the U.S. Attorney's Office for the Southern District of New York, the staff referred those offices to the U.S. Attorney for the Northern District of California.

Thus Federal criminal authorities were on notice of this matter from the outset.

In conclusion, the objectives of the investigation and prosecution were to identify any person who had traded on the basis of inside information; to prohibit such future conduct under the penalty of criminal contempt; and to obtain disgorgement of all illegal profits.

These objectives were achieved. The enforcement staff involved in the Thomas Reed investigation, and I, have each stated under oath that all of his or her decisions with respect to the investigation and completion of this enforcement action were based solely on his or her best judgment, without any external influences or pressures.

Thank you. We'll be pleased to respond to any questions.

[Complete statement follows:]

STATEMENT OF JOHN S. R. SHAD, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION

Chairman D'Amato and members of the subcommittee, as requested, with me today are Commissioners John R. Evans, Barbara S. Thomas and Bevis Longstreth, four members of the Enforcement Division, who conducted the Thomas Reed investigation, John M. Fedders, the Director, Theodore A. Levine, Gary G. Lynch, and L. Duane Cheek, and the Commission's General Counsel, Daniel L. Goelzer. The fifth Commissioner, James C. Treadway, was not a member of the Commission when the Thomas Reed case was considered.

I. INTRODUCTION

The Commission has previously provided this Subcommittee and two House Subcommittees, with copies of Commission documents on this case.

II. OVERVIEW

The following is a brief overview. All of the events in this case occurred in 1981.

On March 5, Amax, Inc., publicly announced a merger proposal from Standard Oil of California (referred to as "Socal") at a price of $78.50 per Amax share. Amax was then trading at $38 per share. The total consideration was approximately $4 billion.

Amax common stock is traded on the New York and other stock exchanges and options on its common stock are traded on the American Stock Exchange.

On the day of the announcement, March 5, the staffs of the American Stock Exchange and the SEC noted the large volume of transactions in Amax options prior to the announcement. Within 24 hours, the American Stock Exchange's staff informed the Commission's enforcement staff that Thomas Reed was one of the purchasers. The staffs determined that his father was an Amax director.

Within a week, the Commission issued a formal order of private investigation that gave the staff subpoena power. During the investigation, the staff learned, among other things, that:

On February 5, certain Amax directors, including Thomas Reed's father, were informed of a January 26 merger overture by the Socal Chairman.

On or before February 25, Thomas Reed's father knew that a special Amax Board meeting called for March 5 was at the request of Socal.

On March 4, following telephone conversations with his father, Thomas Reed called his broker and purchased call options on 50,000 Amax shares, exercisable at $50 per share on or before March 21.

Since the stock was then trading at $38, it would have to rise above $50 within 12 trading days for him to exercise the options at a profit. He paid $3,000 for the options and sold then two days later at a $427,000 profit.

Despite contrary evidence, the SEC staff concluded that there was substantial circumstantial evidence that Thomas Reed had acted on material non-public information.

On November 3, following a discussion of the strengths and weaknesses of the circumstantial evidence and the legal theories on which the case could be brought, the Commission unanimously authorized the staff to file a civil action against Thomas Reed.

As a result of settlement negotiations, the staff obtained a Court order prohibiting future insider trading by Thomas Reed and requiring disgorgement of the $427,000 profit. The Commission unanimously approved the proposed settlement on December 21.

On December 23, the Commission's complaint, which alleged insider trading, was filed and the Order entered in the U.S. District Court for the Southern District of New York. Violation of the Order is punishable by criminal contempt.

III. THE COMMISSION'S INVESTIGATION AND ENFORCEMENT ACTION

The following is an amplification of the facts of the case.

A. SEC Staff Investigation

In the course of its investigation, the SEC staff obtained documents from over 40 persons, brokers and others, and took testimony from over 30 persons, including Thomas Reed, eight employees of his broker, his secretary, his father and four other officers or directors of Amax, the father's broker, and other options purchasers, their relatives and brokers.

B. Results of the Investigation

The staff identified three purchases of Amax options by Thomas Reed—on January 30, February 2 and March 4.

1. The January 30 and February 2 purchases.

While Thomas Reed had substantial holdings in Amax common stock for a number of years, his first purchases of Amax call options occurred on January 30 and February 2. He paid $40,000 for options to purchase 50,000 Amax shares on or before March 21.

Although there had been discussions between the Chairmen of Socal and Amax on January 26, shortly before his purchases, the staff was not able to establish that Thomas Reed knew of these discussions.

On January 26, the Socal Chairman told the Amax Chairman that he would consider recommending to the Socal Board a price in the $70 range for all of Amax's outstanding common stock, but that he had not yet discussed it with his Board. The Amax Chairman said at least $90 per share would be required before he would present it to his Board. The Socal Chairman responded that Socal would never offer that much.

Four days later, on January 30 and again on February 2, Thomas Reed made his initial purchases of the Amax options.

On February 5, the Amax Chairman informed the Amax directors (except the three Socal representatives on Amax's board) of his January 26 conversation with the Socal Chairman, and the position each of them had taken. Thomas Reed's father testified that he did not learn of the January 26 conversation until February 5.

Although the timing of Thomas Reed's options purchases, shortly after the January 26 conversation between the two Chairmen and before the February 5 Amax board meeting, raised questions, the staff was unable to establish that Mr. Reed was aware of the merger discussion prior to those purchases. In addition, given the nature and conclusion of the conversation between the two Chairmen, even had he known, the staff had questions concerning the materiality of the conversation.

2. The March 4 purchases

However, the staff did determine that there was substantial circumstantial evidence that Thomas Reed had received material inside information prior to his March 4 transaction.

On the evening of February 8 and the morning of February 9, three days after his father had learned at the Amax board meeting of Socal's interest in a merger, Thomas Reed testified that they discussed certain business matters concerning Amax, including the fact that Socal owned an interest in Amax and his father's negative views of a greater involvement by Socal in Amax.

On or before February 25, his father was called in Bardados by the Amax corporate Secretary and asked if he could return later that week for a special Amax board meeting, called at the request of Socal. Later that day, he was called and told that the special meeting would be held on March 5.

Thomas Reed's father testified that on March 2 they discussed an investment in another corporation that he was considering.

According to the testimony of both, on March 4, they had two telephone conversations. At 8:13 a.m. Eastern Standard Time, they again discussed an investment in another corporation and at 9:39 a.m., they discussed plans to meet in Connecticut on March 5. Three minutes later, Thomas Reed called his broker in California to pur-

chase call options on 50,000 Amax shares. After three unsuccessful attempts at 9:42, 9:57 and 10:08 a.m. E.S.T., he reached his broker at 11:06 a.m. and placed the order. It was executed that morning, March 4, at a cost of approximately $3,000.

Following the March 5 announcement, Reed sold the options on March 6 at a $427,000 profit.

The proceeds were credited to the accounts of eight of his employees, relatives and close friends. On March 6, he instructed his secretary to have five of the recipients, including herself, open accounts at his broker, which she did.

Also on March 6, he filled out new account and options forms for two of the other recipients and signed their names. He created certain of the information and back-dated the forms to March 2. He also instructed a business associate, the eighth recipient, to back-date her new account papers to March 4.

The staff's conclusion that Thomas Reed possessed material non-public information prior to his March 4 purchases was based on, among other things, the proximity of his purchases and conversations with his father; and the fact that the options could be exercised at a profit only if the stock rose from $38 to over $50 before the options expired in less than three weeks.

However, the staff was unable to discover any direct evidence that he had received inside information. He cited several facts rebutting the inference of wrongdoing. Both he and his father denied under oath that any inside information had been communicated during any of their conversations.

In addition, testimony was provided that he evidenced his intention to purchase Amax options before March 4. A business associate testified that he told her on March 1 that he was contemplating purchasing some Amax options. His secretary also testified that he told her on March 3 that he intended to buy some Amax options the next day, as a gift for certain employees, relatives and friends. And he provided notes, charts and graphs to support his testimony that his decision was made on March 3 and that he had been considering the purchase as early as February 27.

Given such evidence, the staff felt there was more than the usual risk in litigating the case.

C. The Commission Authorizes an Enforcement Action

Nevertheless, the Enforcement Division recommended to the Commission that a civil enforcement action be instituted against Thomas Reed alleging insider trading, specifically violations of Section 10(b) of the Securities Exchange Act and Rule 10b–5. The staff also requested authority to negotiate a settlement prior to institution of the action.

On November 3, the staff discussed with the Commission the strengths and weaknesses of the factual and legal case, including the litigation risks. A memorandum from the Office of the General Counsel was also reviewed. It set forth legal theories supporting and opposing insider trading charges involving options, including a recent Federal district court decision that a corporate insider, such as Mr. Reed's father, owed no duty to persons who traded in options on the corporation's stock. Under the rationale of the 1980 United States Supreme Court decision in *United States* v. *Chiarella*, the federal district court concluded that trading in options on the basis of material, non-public information did not violate Rule 10b–5.

Despite the foregoing, the Office of the General Counsel indicated that several valid legal theories supported the proposition that Reed's father, as an Amax director, and his tippees, were under a duty to disclose material inside information or to abstain from trading.

At the November 3 meeting, the Commission authorized the action and the settlement negotiations.

D. Settlement of the Enforcement Action

The staff proceeded to negotiate a settlement that included a court order prohibiting future insider trading by Thomas Reed and requiring full disgorgement of the $427,000 profit on his March 4 purchases. Violation of the Order would subject him to criminal contempt, including the possibility of fines and imprisonment.

The proposed settlement order would also have required him to irrevocably place the $427,000 in an escrow account, under which the funds would be used, first, to satisfy judgments or settlements relating to pending private litigation, based on his option transactions; and second, to pay any Federal or State taxes that might be assessed as a result of the option transactions. The remainder would be contributed to a charity of his choice.

At a December 17 meeting, the Commission concluded that the proposed settlement Order provided appropriate protection against future insider trading by Mr.

Reed. The Commission also examined whether a provision that had been included in prior settlements of insider trading cases—the use of the disgorged funds for charitable contributions—should continue to be acceptable; and whether respondents should be permitted to offset tax payments against disgorged funds. The Commission concluded that Thomas Reed should not be permitted to use disgorged funds to pay related taxes or to make unilateral charitable contributions.

Mr. Reed's initial settlement proposal also included his mitigation statement that the purchase was made without any attempt at concealment and in good faith. It did not contain the statement that he was consenting "without admitting or denying" the allegations.

The Commission rejected the mitigating language but did not insist on inclusion of the "without admitting or denying" clause. Typically, defendants request this clause in order to negate specifically the assumption that they are admitting the allegations. The Commission has settled cases without the clause, but only with the clear understanding that the defendant will not deny the allegations in the complaint, which was the understanding in this case.

Mr. Reed agreed to the following revisions in the settlement Order. The use of the escrow fund for tax purposes was deleted and any funds that remained after payments to private litigants would be given to a charity agreed upon by the Commission and him, with the Court's consent. He also agreed to the deletion of the mitigating language and the settlement papers were silent with respect to his position on the allegations.

On December 21, the Commission unanimously approved the revised settlement. On December 23, the complaint was filed in the U.S. District Court for the Southern District of New York. After a presentation to Judge Morris Lasker, the Court entered the Order.

On December 23, the Commission issued a press release announcing the filing and settlement. It was reported by the press the next day.

E. Criminal Investigation

With regard to the possibility of referring this case to the Justice Department, during the initial stages of the investigation in March, the staff confirmed that a Federal grand jury for the Northern District of California was also investigating this matter. Subsequent to the settlement, in response to inquiries from the Criminal Division of the Department of Justice and the U.S. Attorney's Office for the Southern District of New York, the staff referred those offices to the U.S. Attorney for the Northern District of Calfornia. Thus, Federal criminal authorities were on notice of this matter from the outset.

IV. CONCLUSION

In conclusion, the objectives of the investigation and prosecution were:

To identify any persons who had traded on the basis of inside information;

To prohibit such future conduct, under the penalty of criminal contempt; and

To obtain disgorgement of all illegal profits.

These objectives were achieved. The Enforcement staff involved in the Thomas Reed investigation and I have each stated under oath that all of his or her decisions with respect to the investigation and completion of this enforcement action were based solely on his or her best judgment, without any external influences or pressures.

Thank you.

We will be pleased to respond to your questions.

Senator D'AMATO. Thank you, Chairman Shad.

Mr. Fedders, do you have any opening statement?

Mr. FEDDERS. I do not, Senator. Thank you very much.

Senator D'AMATO. And at this time, would those who are about to give testimony, please stand and be sworn in?

[Witnesses sworn.]

Senator D'AMATO. Chairman Shad, you've stated that these conclusions were arrived at with no external pressure.

At any time during the Reed investigation, were you or any member of the staff, that you're aware of, contacted by any representatives of the White House, or by any other agencies in connection with the Reed case, other than the Justice Department?

Mr. SHAD. Not to my knowledge.

Senator D'AMATO. Mr. Fedders?

Mr. FEDDERS. The same. Not to my knowledge, Senator.

Senator D'AMATO. Who had the day-to-day responsibilities with respect to this particular investigation?

Mr. SHAD. Gary Lynch was the principal attorney on the case. He was under the supervision of Mr. Fedders and Mr. Levine.

Senator D'AMATO. Are Mr. Lynch and Mr. Levine here?

Mr. FEDDERS. They are. There's a third attorney involved in the matter as well, that you probably should address.

That is Duane Cheek. Mr. Levine, Mr. Lynch, and Mr. Cheek are all with us.

Senator D'AMATO. I wonder if we could swear them in as well? Would you please all rise?

[Witnesses sworn.]

Senator D'AMATO. As I asked Chairman Shad and Mr. Fedders the question, I'd also like the comments from the three of you.

At any time during the investigation, were you or any of your staff or representatives contacted by the White House or any other agency, other than the Justice Department, in regard to the Reed case?

Mr. LEVINE. No.

Senator D'AMATO. Mr. Levine, no one contacted you, officially or unofficially?

Mr. LEVINE. No.

Senator D'AMATO. No one asked you anything with respect to this matter at any time during that investigation?

Mr. LEVINE. No, sir.

Senator D'AMATO. Mr. Lynch?

Mr. LYNCH. I will give the same response. No.

Mr. CHEEK. The same response. No.

Senator D'AMATO. Mr. Fedders, the complaint in the *Reed* case was filed in the U.S. District Court for the Southern District of New York in 1981.

Why didn't the complaint allege forgery and fraud based on Mr. Reed's actions surrounding the sale of the options he purchased on March 4?

He admitted having signed forms for intended beneficiaries and backdating the brokerage forms. Yet there was no mention of that in that complaint.

COMPLAINT INCLUDES ALLEGATIONS OF FRAUD

Mr. FEDDERS. Senator, the complaint does include allegations of fraud with regard to Mr. Reed's conduct. There are allegations of violations of section 10(b) under the 1934 act, and rule 10(b)(5) thereunder.

The principal thrust of the investigation was whether there had been trading on the basis of material nonpublic information.

That was where we were going. In the settlement context, we did not believe it was necessary to raise the question as to whether there had been forgeries.

So we covered the fraud issue. We did not address the forgery issue. If this had been a litigated case where we were arguing

about the full course of conduct, I suspect we would have set forth the full course of conduct to establish a state of mind.

But a decision was made by Mr. Levine, Mr. Cheek, and myself, that it was not necessary to do that since the gravamen of the action was insider trading.

Senator D'AMATO. Are you convinced there was insider trading in respect to this case?

Mr. FEDDERS. I would not have made the recommendation if I did not believe so, Senator.

Senator D'AMATO. Is it true as you're recorded in "Common Cause" to have said, quote, that "anyone who engages in insider trading is clearly a thief?"

Mr. FEDDERS. That's my personal view, Senator.

Senator D'AMATO. It's my view, as well. I think it's a view that the majority on this committee would share.

THE ACCUSED NEITHER ADMITS NOR DENIES THE CHARGES

Traditionally when the SEC settles an insider trading case, they include the stipulation, the phrase, "The accused neither admits nor denies the charges."

Would you first tell this committee why that phrase is used?

Mr. FEDDERS. The phrase "neither admitting nor denying" is a negotiated term. When a settlement is made with the Securities and Exchange Commission, a prospective defendant and his counsel are concerned about the collateral consequences that would arise from that settlement.

And the concern has been expressed over the years if there is no admission or denial, whether there in fact is an admission by reason of the settlement; and then consequently whether in fact the settlement can be used in collateral civil or criminal processes.

Traditionally defense counsel, with the consent of the Commission, has been permitted to included that language so there would be no collateral consequences arising from the settlement.

Senator D'AMATO. However, the fact is that this phrase and this stipulation, which is generally the case, in the Reed matter, was not included.

Additionally, Mr. Reed's attorney boasted that this was highly unusual for the SEC to agree to such a settlement. As a matter of fact, the inclusion of that phrase, "The accused neither admits nor denies the charges," is generally something that the SEC insists upon; is that not correct?

Mr. FEDDERS. Not always insists upon, Senator. Let me address several aspects of several questions that you raised.

First of all, it is correct that traditionally the language, "without admitting or denying," you would find in most settlements.

But it is not universally true. We could point you to a number of settlements where the language has not been used.

Negotiations over changes in any potential securities suit are intensive. Those settlement negotiations generally are protracted, and last over a period of time.

As Mr. Levine or Mr. Lynch could tell you, in this particular settlement context, counsel for Mr. Reed insisted that the language not include the words "without admitting or denying."

From our personal point of view, we believe that that was not adverse to the Commission's interests in this case. There are a number of Federal district court decisions that include an analysis of the language, "without admitting or denying," and several have said if there is neither an admission or a denial that it is reasonable to presume that there has been an admission.

I would call upon one of my colleagues, Mr. Levine or Mr. Lynch, if you'd like, to describe the negotiations which took place in this particular case with regard to that language.

Senator D'AMATO. I think that would be useful to the committee.

Mr. LEVINE. I can give you a brief statement. Mr. Lynch can give you a more detailed statement.

It is my personal position that the clause is for the benefit of the defendant.

The United States Court of Appeals for the District of Columbia, in a recent case entitled *SEC* v. *Clifton*, also has affirmed that position for the following reason.

The way this came about is in settlements—I've been at the Commission for 13 years, and I've handled hundreds of settlements—is that the defendant wants to say, without admitting. For the reasons Mr. Fedders pointed out, the Commission did not want to be in that position because it suggested that he was denying.

So, we suggested, if you want to say anything, you have to say both.

We don't want it for our benefit, because as long as the person is not denying it, in this case, where Mr. Reed's counsel said he doesn't want it, we said, "Fine. But you have to agree, and you have to understand, as part of the settlement, that you will not deny it."

He said he understood that, and that was a part of the case.

So, I felt we have our bare allegations. The matter is resolved. It goes before a court. And there is no denial by Mr. Reed. That, to me, is an appropriate resolution of the case. And that was the only consideration given to it.

Senator D'AMATO. Mr. Levine, if I might—while we're still on this matter, did there come a period of time when Mr. Morris spoke to you in regard to this case, Mr. Morris from the National Security Council?

Mr. LEVINE. Yes, sir. Mr. Morris spoke to myself, Mr. Lynch, Mr. Cheek, and Susan Paccaro.

Senator D'AMATO. Did there come a time when he asked you, relative to this matter, whether or not Reed lied when he denied possession of material nonpublic information?

Mr. LEVINE. Yes, sir.

Senator D'AMATO. What did you say to him?

CONFLICT AND CONTRADICTION

Mr. LEVINE. I said to Mr. Morris that I did not want to provide a direct response to that question. But I said, although it was a difficult decision in a case, we believed we could establish, by a preponderance of the evidence, that he had engaged in insider trading. He had Mr. Reed's testimony, where he denied that he possessed the inside information.

And I felt I was performing my job of informing him of the Commission's position and not resolving a question of lying or not for him when that information was in his possession.

Clearly, I pointed out the conflict and the contradiction.

Senator D'AMATO. Are you responding to me from a memo that you have there, that you possess?

Mr. LEVINE. I wasn't reading from it, but I was referring to it.

There was a memo that I think has previously been provided to the committee.

Senator D'AMATO. The fact of the matter is that you did not respond to his question as to whether or not you felt he was lying in that matter; is that correct?

Mr. LEVINE. I refused to provide a direct response, sir.

Senator D'AMATO. Would you respond to this committee if I were to ask you whether or not you felt Mr. Reed had lied in connection with this matter?

Mr. LEVINE. You put me in a very difficult position, and I'm not trying to avoid this.

I will respond the way I think best.

Senator D'AMATO. You have now handled these matters for how many years?

Mr. LEVINE. A little over 12.

Senator D'AMATO. You have come into possession of these facts in terms of the transactions, the manner in which they were made, and those events prior to the transactions and the purchase of those options.

Are you telling this committee that you haven't formed an opinion and a judgment with respect to this matter and whether or not Mr. Reed was testifying truthfully when he indicated that he did not discuss these matters with his father with respect to Amax and the so-called purchase and that thereafter he made repeated phone calls to his broker 2 minutes after, 10 minutes after, 30 minutes after?

I suggest to you, if it wasn't Mr. Reed, if it was somebody else, Mr. XYZ, John Q. Public, would you have formed the same basis? And would you be so reluctant to give us an opinion?

Mr. LEVINE. I am not reluctant to give you an opinion.

Senator D'AMATO. Would you give us an opinion then.

Mr. LEVINE. I did not have a chance, Senator, to respond to your question.

My response to the question is: In a case which I thought was a difficult case, but one I was convinced that we could establish circumstantially that he had possessed inside information, his statement that he did not possess the information, which was contradictory, I thought that was inaccurate.

Senator D'AMATO. It was inaccurate?

Mr. LEVINE. Yes.

Senator D'AMATO. Do you believe it's realistic to believe, given the sequence of phone calls that was definitely established—is that right, were they definitely established? Did you establish that?

Mr. LEVINE. The investigation by the staff established, through telephone records and other information, that there was a sequence of phone calls which, I believe, the chairman, in his statement, set forth.

Senator D'AMATO. And that record is quite clear? It's accurate in terms of the sequence of the phone calls from Washington initiated by Mr. Reed to his father, who was a member of the Board of Directors, in Barbados?

Mr. LEVINE. Senator D'Amato, the calls at that time I believe were not in Barbados.

Mr. LYNCH. Yes, they were from Barbados.

Senator D'AMATO. From Washington to Barbados, then from Washington to California?

Mr. LEVINE. Yes, sir.

Senator D'AMATO. That information is factual. It is correct; is it not?

Mr. LEVINE. Yes, sir.

PLACING OF OPTIONS FOR RELATIVES AND FRIENDS

Senator D'AMATO. The subsequent orders thereafter by Mr. Reed, from Washington to California, with his broker and the subsequent placing of the options in other names thereafter, has that been factually ascertained?

Mr. LEVINE. Yes, sir.

Could I provide you with one or two facts?

I find myself in a curious position, because I recommended that the case be brought. I think there was a case there.

Senator D'AMATO. I commend you.

Mr. LEVINE. My feeling—and we have to make these judgments every day—I made the judgment, whether it's X or Y, solely on the facts of the case—is that there was contrary evidence which I had evaluated.

It's easy sometimes to make those judgments. But when you're in the position of trying to evaluate a record and when the Government sues someone, it's a serious matter. And you have to carefully evaluate the record.

I tried to evaluate all the facts. That's what I did here.

I concluded, as you have—although you haven't had the benefit of the entire record that I had—that there was trading and that his testimony was inaccurate on that point.

But it was a close question, because there were other facts that Mr. Lynch and Mr. Cheek can give you.

Let me just point out there is other testimony—which I have to discredit—which says that Mr. Reed spoke to other persons before he ever spoke to his father on March 4 and indicated that he was going to buy additional options and buy them for relatives and friends.

And this is other sworn testimony, under oath.

Senator D'AMATO. Who gave that testimony? His secretary?

Mr. LEVINE. And a business associate.

And I would have had to, therefore, say Mr. Reed's father was lying, he was lying, his secretary was lying.

Senator D'AMATO. Didn't he place some of the stock in his secretary's name?

Mr. LEVINE. Yes.

Senator D'AMATO. How credible do we find that?

Do we really believe his father is going to admit or say or contravene the testimony of his son?

These are judgments you've been making for 12 years.

Mr. LEVINE. Senator D'Amato, my only point——

Senator D'AMATO. Do you find that worthy of belief, that he really called his father—to Barbados—then his broker, called his secretary?

And what credence are we going to put in it, that thereafter, once this matter was put under investigation, that that is credible evidence to contravene or contradict the facts in this case that would lead any reasonable person to believe that there was insider trading?

Mr. LEVINE. Senator, I was merely pointing out to you—trying to give you my thought process.

Senator D'AMATO. Isn't that more like establishing an alibi?

Mr. LEVINE. I was trying to give you the factors that I weighed in my professional judgment on both sides of it.

I concluded that, despite contrary evidence——

Senator D'AMATO. Would you call that evidence?

Contrary to what?

Mr. LEVINE. Senator D'Amato, I have sworn testimony from four or five other persons.

Senator D'AMATO. Contrary statements or depositions that were made?

Mr. LEVINE. Contrary statements.

All I wanted to point out was that I wanted to give the committee the benefit of both sides of my analysis, even though I came to the conclusion that he had the knowledge, based on the facts. I am not trying to go beyond that.

Mr. FEDDERS. Senator, could I add a point here?

Senator D'AMATO. Certainly.

Mr. FEDDERS. In the position that Mr. Levine has and I have, we do not engage in the taking of testimony on a day-to-day basis. We're engaged in running the Division of Enforcement.

And when staff members of the quality of Mr. Lynch and Mr. Cheek give information—and they're two of the finest members in the Division—our only question to them is: "What's your proof?" That's really our main job.

Senator D'AMATO. What do you think—with respect to this proof, how much better could you ever get the proof unless you have a person who participated in this who came forth and admitted?

So, admittedly, it is circumstantial. But I think we're talking about a clear preponderance of the evidence; is that not the case?

Mr. FEDDERS. We believe there was a clear preponderance of the evidence. But from a lawyer's point of view, and knowing that we have to prosecute these cases and that when the force of the Government makes an accusation against an individual, we do it with the highest degree of professionalism we can bring to it.

EVIDENCE ENTIRELY CIRCUMSTANTIAL

I have to remind you that there was not an element of direct evidence in this case. The matter was entirely circumstantial. We had

no elements of contradictory testimony from individual A or individual B.

I agree with you that there was overwhelming circumstantial evidence in this case, which led us to make a recommendation to the Commission.

But I again feel, as a professional responsibility, to point out to you that it was not direct evidence. It was entirely circumstantial.

Senator D'AMATO. How many cases do you get direct evidence?

Mr. FEDDERS. We do a lot. In the insider trading area, you sometimes don't, because people do not memorialize it.

Senator D'AMATO. Talking about insider trading, is it a fact that this is about as good a case as you are going to get in terms of insider trading?

Mr. FEDDERS. No. We felt there were really very unusual litigation risks in this case.

Senator D'AMATO. I'm not criticizing your going forward in terms of litigation. But in terms of the characterization of the mitigating evidence, I think that that is some of the weakest kinds of things.

It's like my saying that my children came in and said, "Oh my gosh, dad—daddy was home."

They'd say almost anything if I was accused of being around the corner where there was a crime that was committed.

I think anybody's children would say the same thing, I would hope.

How much faith do you put in that kind of deposition?

Let me ask one other thing.

Senator RIEGLE. Mr. Chairman, would you yield just for one question right at that point, before we lose this.

Senator D'AMATO. Yes.

Senator RIEGLE. Am I correct in thinking that Mr. Reed also contacted, at the same time, two other members of the Amax board?

Didn't he contact former-President Ford and didn't he contact Mr. McGregor in the same timeframe?

Mr. FEDDERS. Let me give you the specifics of that. I think the person best to do that is Mr. Lynch.

Senator RIEGLE. I don't want to disrupt the Chairman's line of reasoning here. But isn't the fact there were other contacts with insiders at Amax besides Mr. Reed's father in this time period?

I think it's important to nail that down. I'd be interested to know if you talked to those other people and with whom you spoke.

Mr. LYNCH. I believe that Thomas Reed testified that he spoke to former-President Ford in early January. I believe it was January 12 or January 13.

He also testified that he spoke to Ian McGregor, who is a resident of England—London, England—and who sat on the board of Amax.

Senator RIEGLE. Mr. Ford did, as well, did he not?

Mr. LYNCH. Yes, he did. They were both board members.

He spoke to Ian McGregor, however, on February 3, which is after his purchases.

We made the determination that his conversation with Gerald Ford was so much prior to the contact from Socal to Amax that it was not necessary to interview him.

Senator RIEGLE. Well, if I'm not mistaken, he spoke with McGregor on February 3--then, in turn, 2 days later. That was in February. Then, in March, Reed bought 500 more options.

But my question to you is that knowing that he contacted two other Amax board members in the same period, if you've taken depositions from them——

Mr. LYNCH. We did take the deposition of Ian McGregor, because his contact, that we knew about through a phone record on February 3, which was—albeit after his purchases, we still thought it was important to talk to him about the substance of his conversation.

Ian McGregor testified that he did not communicate material nonpublic information to Mr. Reed—moreover, that he did not have material nonpublic information at that time.

Senator RIEGLE. I'll pursue that later.

Thank you, Mr. Chairman.

Senator D'AMATO. Before I yield to Senator Proxmire, who has been most gracious in allowing me additional time to pursue this line—just so we can start the various lines of questioning—Mr. Morris asked you, Mr. Levine, "whether or not it would be inappropriate for a man of Reed's character or background to be in a position involving national security interests."

I'm reading from the memo dated June 15, 1982, which you have in front of you.

You went on to say that "the only personal comment expressed to Mr. Levine," the memo says, "was that he did not believe Reed had a systematic weakness, but had made a mistake."

What do you mean by that, he didn't have "a systematic weakness, but he made a mistake"?

Mr. LEVINE. My response was, in total, that the enforcement staff was not in the position to make a judgment—that a better evaluation could be made by reviewing the FBI's background investigation and his career as a whole.

My only personal comment was I didn't believe Reed had a systemic weakness, but made a mistake.

Senator D'AMATO. A "systemic weakness," OK, "but made a mistake."

Senator Proxmire.

Senator PROXMIRE. Mr. Levine, did I understand you to just say to the Chairman that you had recommended that a case of insider trading be brought against Mr. Thomas Reed?

Mr. LEVINE. Yes, sir.

Senator PROXMIRE. To whom did you recommend that?

Mr. LEVINE. I recommended that to the Commission. Actually, formally, it would go through Mr. Fedder, and then to the Division.

RECOMMENDATION FOR PROSECUTION TURNED DOWN

Senator PROXMIRE. Who made the decision to turn down your recommendation and not turn it over to the Justice Department for prosecution?

Mr. FEDDERS. Senator, that determination—I think we're mixing a few apples and oranges.

Let me put it in some order. The recommendation from the Commission—first, from my staff to me and from us, as a unit, the Division of Enforcement, to the Commission was that a civil enforcement action be initiated.

There was no recommendation from us—from the staff to me or from the Division of Enforcement, as a unit, to the Commission—that there be a criminal reference in this case.

A legitimate question is: Why not?

During the course of the investigation——

Senator PROXMIRE. First, I want to make sure I understand. Did you or did you not follow the recommendation of Mr. Levine?

Mr. FEDDERS. I did.

Senator PROXMIRE. You did.

And you would call this settlement the kind of recommendation Mr. Levine made?

Is that your understanding, Mr. Levine?

Mr. LEVINE. I'd like to answer. The record is confused on that.

Senator PROXMIRE. Maybe my question isn't as precise as it ought to be.

What I'm trying to get at is whether or not your recommendation was accepted by the SEC and then, in turn, negotiated a settlement with Mr. Reed which was what you had in mind?

Mr. LEVINE. Sir, I recommended that we institute the action based on the March 4th transactions. I did not think we could prove the earlier ones.

The Commission authorized that—authorized us to negotiate and authorized the settlement and accepted the settlement. There was no inconsistency in that sense.

The authorization was given. We negotiated. The settlement was entered into.

Senator PROXMIRE. You did not have in mind, in other words, a recommendation to the Justice Department for prosecution?

Mr. LEVINE. That gets to the second question—and that is, as I think the Chairman's prepared remarks said—when we first got involved, we were alerted to the fact—and it was confirmed—that there was a grand jury investigation of this matter going on.

At that time, we made a judgment, because of what we call parallel proceeding problems, not to communicate with the U.S. Attorney directly, because we were doing our own investigation. And this is at a very early point in time—I think in March or April of 1981. Because there was a subsequent case that came down called the *Dresser* case, which raises concerns where civil and criminal prosecutors are exchanging information when you go down the investigatory route.

We were aware of that. We were aware of the grand jury's subpoenas being issued and the investigation going on.

Then, after the case was brought and was settled, there were subsequent communications with both the U.S. Attorney for the Southern District of New York and the Department of Justice both.

When we got those, we referred them to the U.S. Attorney in San Francisco. Because we assumed that the criminal authorities would deal with it themselves, we did not, therefore, based on all that knowledge, consider and make a determination that we should or should not refer those specifically, because we were already

aware that it was being reviewed by criminal authorities. And I assume that they are competent and will make the judgments. And there was a grand jury actually looking at the transactions.

Senator PROXMIRE. Do you have anything to add to that, Mr. Fedders?

Mr. FEDDERS. No, I don't. When you first asked, Senator, I thought you were intimating that there might have been some inconsistency in the recommendation between my staff to me, and then to the Commission. I want to assure you there was no inconsistency at all.

Senator PROXMIRE. Then as I understand it, because there was a grand jury in California that was acting in this case, you thought that as far as you were concerned you'd turn the information you had over to them, and that was it; is that correct?

Mr. LEVINE. I just want to qualify that, because we didn't turn it over. They had their own going on, before we even started. In other words, as of March 1981, before we had documents, they were issuing subpoenas and getting documents themselves. We didn't make a judgment, just passed the issue. We did not take that step, but it was our own judgment that there was an ongoing investigation, and we just never focused on the issue because of that fact. They certainly knew we were investigating, and they certainly knew we brought the case. And no one came to us.

Senator PROXMIRE. Well, in this case, there was no criminal prosecution in question. It has been announced by the U.S. Attorney for the Southern District of New York, John Martin, that there is an investigation that was in the press less than 2 weeks ago.

Mr. LEVINE. And they do have our files.

Senator PROXMIRE. All these events took place more than a year ago, the activities by Mr. Reed; is that right?

Mr. FEDDERS. His activities took place in March of 1981. The Commission's enforcement action took place in December 1981, but it was in that March-April context, where the staff advised me—I was not at the Commission until July of 1981, but when I arrived—that a U.S. Attorney in the San Francisco area was conducting an investigation.

Senator PROXMIRE. You say there still may be a criminal prosecution by New York?

Mr. FEDDERS. It is so reported in the newspaper, and I think for us to publicly comment beyond that would be inappropriate.

U.S. ATTORNEY REQUESTS SEC FILES

Mr. LEVINE. Just to give you a complete record, however, the U.S. Attorney has asked for our files, and we have turned over all the documents to them.

Senator PROXMIRE. From the testimony that you have given us this afternoon, it seems to me that you rarely do recommend criminal prosecution on so-called insider trading operations; is that right?

Mr. FEDDERS. The question of referral is a technical word. Referral means when the Commission on its own initiative makes a referral to the U.S. Attorney's Office. The other way, and the more frequent way that information is transmitted to the U.S. attorney,

is through the access process. A U.S. attorney will read in the press or through any number of intergovernmental communications among law enforcement agencies that we have initiated a proceeding or that we have an investigation going on, and they will write Mr. Levine or myself and ask for access to our files.

This is by far the overwhelming manner in which criminal law enforcement agencies learn of our investigations. Today, insider trading is a matter of significance to the Commission. The press seems to be paying a lot of attention to it. I know that the Senate and the House are both interested in what we've done in this area. In many of these investigations, the Department of Justice requests access to our materials.

Last year, the late Congressman Rosenthal wrote to Chairman Shad and myself asking us for some statistics in this area, and we provided those to him. I do not have up-to-date statistics at this time.

Senator PROXMIRE. Did the SEC ever reach a formal conclusion that this case warrants criminal prosecution?

Mr. FEDDERS. It has not.

Senator PROXMIRE. One way or the other?

Mr. FEDDERS. It has not.

Senator PROXMIRE. I take it that because it's so rare that you get specific concrete evidence of insider trading—that almost never happens; is that correct?

Mr. FEDDERS. That's correct. But there are some cases where you get it.

Senator PROXMIRE. Can you tell me how many? How long have you been in your present position?

Mr. FEDDERS. I've been there just short of 2 years.

Senator PROXMIRE. In almost 2 years, how many insider trading cases have been brought that have gone to criminal prosecution?

Mr. FEDDERS. I'd have to sit down and study.

Senator PROXMIRE. Have there been any?

Mr. LEVINE. Yes. I can just give you some. We indirectly were involved in the *Newman* case in the southern district of New York, which involved Morgan Stanley, and tipping information out of there. We were involved in the *Florentino* case.

Senator PROXMIRE. How many were there? I don't want you to go through all of them?

Mr. LEVINE. I would say five or six cases in the last couple years, but I would—could I clarify something? In my experience, it is rare to bring a circumstantial case alone in any matter before the Commission. Normally, you have persons possessing information, but at least someone whom they spoke to having it and the person possessing it. I think what struck me in this case as not unique but very unusual, was that there was no direct evidence at all that we could show he had the information. Sometimes people deny having it or they deny access to it, but we had no one who could testify directly that the man had it.

Mr. Fedders is correct in saying that it becomes circumstantial.

Senator PROXMIRE. The reason I am getting into this is because I think one of the more significant aspects of this investigation is what are we going to do about insider training? Mr. Fedders, I think you were absolutely 100 percent correct when you said insid-

er training is clearly thievery. That is exactly what it is. I can't think of anything more destructive of confidence in the markets than this kind of action.

Let me ask you, has the SEC recommended legislation to strengthen the civil penalties and other damages assessed against those engaged in insider trading to make enforcement more effective?

Mr. FEDDERS. Senator Proxmire, we have, and it is coupled with the initiative of Chairman Shad and the other three commissioner who are here.

Senator PROXMIRE. Can you tell us what it is that you have recommended?

Mr. FEDDERS. Yes. We have recommended to the Senate and the House, that in addition to the insider trading cases where we use our equity authority to obtain disgorgement, meaning the amount of the ill-gained profits that a person might receive, that the Congress authorize us to ask Federal district courts for a sanction up to three times the amount of the ill-gained profit.

Senator PROXMIRE. What is the status of that legislation?

Mr. FEDDERS. It's been introduced into the House of Representatives by Congressmen Dingell and Wirth. It was to be introduced yesterday in the Senate, or it is about to be.

Senator PROXMIRE. May I be a cosponsor of that?

Senator D'AMATO. Absolutely. Now we are assured of its passage.

Senator PROXMIRE. Let me ask you this, Mr. Shad. My time is almost up, but let me ask you. The SEC's records in the Reed matter indicate that Reed claimed that the timing of his option purchases and his phone calls to his father was merely a coincidence, and that he had no advance knowledge of the forthcoming stock purchase offered by Socal. This has been asked in several ways. But let me now, if I can, ask it from you, Mr. Shad.

Did the SEC or its staff believe Mr. Reed's story?

Mr. SHAD. I'd have to say it the other way. Their belief and the Commission's belief was that there was a strong circumstantial case that could be made that he did have inside information. I can't say "believe," if you mean by that "know," because we didn't.

Senator PROXMIRE. By bringing the action against Mr. Reed that you did, after hearing his explanation, were you not concluding that he was not telling the truth?

Mr. SHAD. I think we were just concluding that we had a strong circumstantial case, a very strong circumstantial case, but there was very important——

Senator PROXMIRE. Would you force him to take the action he did, if you believed he was telling the truth?

Mr. SHAD. Our focus is on whether we can sustain the case.

ACCUSATIONS

Senator PROXMIRE. Here is what you accused him of doing, engaging in acts, practices or courses of business which are operating as a fraud and deceit of purchasers and sellers of Amax securities and other persons.

Mr. SHAD. That's right. That's 10b–5. That's what we were charging him with.

Senator PROXMIRE. Doesn't mean you didn't believe him?

Mr. SHAD. It does mean we believe we had a very strong circumstantial case, but I don't think that the subcommittee should lose sight of the fact that there was strong evidence to the contrary. We had sworn testimony from credible witnesses that there hadn't been insider information passed, and you had some records that he had kept which also substantiated the statement that he did not have inside information at the time he exercised the transactions.

Senator PROXMIRE. In other words, you had solid circumstantial evidence that he was not telling the truth. You had statements, but you had no real evidence that he was.

Mr. SHAD. That's right. We didn't have firm evidence. We had a strong circumstantial case, so we were pleased to go to a settlement. In fact, in my opinion, we got out of that settlement everything that we could have hoped to have gotten out of a fully litigated case.

Senator PROXMIRE. My time is up. But you had direct evidence of falsification of documents, forgeries and so forth. It was direct, explicit and admitted.

Mr. SHAD. That's right. That was the case.

Senator D'AMATO. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

Mr. Shad, you were asked by the chairman if you were approached by anybody in the Reagan administration as this matter was under review and being ready to be brought to a decision. And you said you were not. Were you approached by anybody outside of the administration in this issue?

Mr. SHAD. Never.

Senator RIEGLE. Did you talk to Thomas Reed about it?

Mr. SHAD. Not at all.

Senator RIEGLE. Did any of the rest of you receive any contacts from anybody else outside the administration? Mr. Fedders?

Mr. FEDDERS. I received no contact from the administration. I did not participate in the settlement discussions with the attorneys. Obviously, Mr. Reed's counsel argued on his behalf with my colleagues. So if you are talking about an outside contact, we certainly received a contact from his counsel, but I've sworn to an affidavit today, as have my colleagues, as has Chairman Shad, that we were not improperly influenced in this case. We were not contacted by the White House. We were not contacted by Thomas Reed, by any of his friends, or by anyone else who attempted to exert any influence on us in any way whatsoever.

The only caveat I have to that, is that we were properly contacted by his counsel, who vigorously argued his innocence and then negotiated with us.

Senator RIEGLE. So then what you are saying is that the only person that you discussed this with, at any time, was his legal counsel. Is that correct?

Mr. FEDDERS. Outside of the Commission.

Senator RIEGLE. Outside of the Commission.

Mr. FEDDERS. Within the Commission, we all discussed it.

Senator RIEGLE. On that matter——

Mr. FEDDERS. I'd like to turn to my colleagues, Senator, if I may, because this is such an important area that you dwell on, for you

to receive reassurance from each of them that they support that statement, because I speak for myself.

Mr. LYNCH. I would just like to add that we obviously took the testimony of Mr. Reed, so we met him in that context. Duane Cheek and myself also met with Mr. Reed and his counsel very early on in the investigation to discuss the investigation.

Senator RIEGLE. But only in what would be thought of as a normal conduct of the matter?

Mr. LYNCH. Precisely.

Mr. LEVINE. Excuse me, if you want to get the full—my answer is, don't——

Senator RIEGLE. The full answer.

Mr. LEVINE. I just wanted to complete your record, so people will have the context. I would like to tell you that no one has ever attempted to influence me in any case and especially this case. I'd be the first one to yell if they did. This case was handled simply in our the best professional judgment.

Mr. FEDDERS. Mr. Cheek, do you wish to address that?

Mr. CHEEK. I have the response that Mr. Lynch and Mr. Levine have.

Senator RIEGLE. I tend to feel that the professional staff here, from what one can determine, did the work that should have been done. I have a serious question in my own mind whether the Commission went as far as perhaps it should have gone. So what concern I have tends to fall more in that area, and that's only part of the story, because once you've finished with Mr. Reed, there is the question of the whole chain of events which led up to his taking one of the highest security positions in our Government. In fact, there was not a full field investigation by the FBI, and other things that would not directly fall within your purview. So you're here really only to comment on part of this chain of events. And I hope we will track down the entire chain before we are done.

In your November 3 meeting at the Commission, when you authorized the action and the settlement agreement, are there minutes available from that meeting?

Mr. SHAD. Yes.

Senator RIEGLE. Could those be made available to this committee?

Mr. SHAD. I believe they have been.

Senator RIEGLE. Do we have those, Mr. Chairman? The minutes? Is there a complete transcript of that meeting?

Mr. SHAD. No, there is not a complete transcript.

Senator D'AMATO. There is a written summary of notes.

Senator RIEGLE. Was there a transcript taken at that meeting?

ERASURE OF TAPES

Mr. SHAD. There is a tape recording, but it is erased after a matter of months. They are not kept indefinitely. It is a standard operating procedure after, I think, 3 months, all the tapes are erased.

Senator RIEGLE. So there is no verbatim transcript available of that meeting?

Mr. SHAD. Not to my knowledge. Is there?

Senator RIEGLE. Are you certain?

Mr. FEDDERS. Senator, I've had confirmed to me, as early as this morning, in speaking with George Fitzsimmons, the secretary—I raised that question. He told me that the normal course is, as Chairman Shad has indicated, that after a meeting, a period of time goes by, which he did not specify, but the tapes are erased at a time when the minutes are completed and approved. I am recalling what he told me this morning and that the tapes of that meeting no longer exist. They have been erased in the normal course and fashion.

Mr. GOELZER. They are erased 1 month after the minutes are final. So it presumably would have been sometime early in 1982.

Senator RIEGLE. Are the minutes a summary document or are they an attempt at a verbatim transcript?

Mr. SHAD. They are not a verbatim transcript, but they are rather detailed.

Let me ask, has the committee been provided copies of the memoranda that went to the Commission?

Mr. FEDDERS. Yes, they have.

Mr. SHAD. What you have, in terms of the issues involved, both issues of fact and law, is an extensive memorandum prepared by the staff proposing this action, the initial settlement and the subsequent meetings of the Commission that were held on that.

Senator RIEGLE. Let me just say that the letter to Mr. Harris which conveyed a variety of documents, does not include in the summary of 11 items any either summary transcript of the November 3 meeting or anything else.

Mr. FEDDERS. Senator, what letter are you referring to? Maybe I can refer on my own.

Senator RIEGLE. Now let me understand. It is a written summary, not a verbatim transcript; is that right?

Mr. SHAD. Yes.

Mr. FEDDERS. That's correct.

Senator RIEGLE. Does there exist any more complete record of that meeting that you could find? Would anybody have a more complete record of that meeting?

Mr. FEDDERS. Senator, I will certainly undertake to inquire to find out. I don't know of any. It would be unusual if there were.

Senator RIEGLE. So as a matter of course, there is not an effort made to transcribe this transcript?

Mr. FEDDERS. Commissioner Longstreth has just recalled for me that sometime after the meeting in 1982, I drafted a memorandum to the Commission's enforcement staff in Washington and to the 15 regional and branch offices throughout the country addressing certain aspects of the discussion that took place at the table with regard to the disgorgement, the amount of the disgorgement, the language of the settlement, so that the staff would have the education and the benefit of what the Commission discussed at that time. That document was only called to my attention this morning by Commissioner Longstreth when he asked me for it, and it has not yet been turned over, but it is one that, indeed, we will be proud to turn over.

Mr. LEVINE. It really doesn't go to the first meeting as much as the consideration of the settlement, to answer your question direct-

ly. It's the normal process to just have the minutes. And the only reason there is a tape is for different considerations. We can provide that information to you.

Our memorandum to the Commission, I think, is something you would like to see, because it sets forth—we can provide that.

Senator RIEGLE. I'd be interested in the give and take around the table, is what I am really interested in.

Mr. LEVINE. We don't have it.

Senator RIEGLE. I understand that that tape is gone, so we don't have that information in a verbatim way. Would you all have notes from that meeting?

Mr. LEVINE. We can check.

Mr. FEDDERS. I don't.

Senator RIEGLE. I would appreciate it if you would take a look and see. I would like to be able to reconstruct as much as possible what actually was said there, because that is where the judgments were made.

Mr. GOELZER. Senator Riegle, just in the interest of completeness of the record, I want to point out that while all the tapes of the authorization of the Reed case have been erased, there was a discussion much subsequent to that concerning the White House's request to access to the files on the Reed matter. There apparently is an existing tape of that. I believe that is just a pro forma authorization to turn those files over.

Senator RIEGLE. Would there be a list? I take it, any materials that have been forwarded to the White House, we would also receive here at the committee?

Mr. GOELZER. I don't know the answer to that.

You certainly received a large part of our files.

Senator D'AMATO. Obviously, that will be forthcoming, I am sure; is that not correct, Mr. Chairman?

Mr. SHAD. Yes. I don't know of anything that was provided.

Senator D'AMATO. I think more appropriately might be the question, Senator Riegle, to go right to the point as to what, if anything, did Mr. Morris do in his inquiry in connection with the White House or with the Justice Department or those procedures, to ascertain from the Commission what efforts were made in this case. What the status was might be put forth. At this time, I am only aware of the one meeting where Mr. Morris came in, and put questions to Mr. Levine and others with respect to the background and what their opinions were.

Are there others? Is there other information that you have, were there other contacts that were made?

ADDITIONAL INFORMATION AND CONTACTS

Mr. FEDDERS. There are two things I should call to your attention, Senator. Both of which are maybe generally known, but maybe misunderstood and not recalled by people at the present time.

In late 1982, approximately 1 year after the Commission's enforcement action, at the time the Common Cause article was being announced that it would be published within a few days, it was being announced in the Washington Post, I either spoke with Fred

Fielding at a Christmas party at the Office of the Counsel for the President, or by telephone. I can't recall.

And this case was receiving publicity. In a casual moment, I believe it was at the Christmas party that I attended, he suggested that we might get together to discuss this further, and to seek my assessment of the matter at that time.

The immediately following day, which I believe was December 21, at the Commission meeting, I told the Commission of that inquiry and sought authorization from the Commission to meet further, if necessary.

Senator D'AMATO. Give us the date. December 21?

Mr. FEDDERS. 1982. Just 2 days short of 1 year after the conclusion of the enforcement action, and at the time of the Common Cause article receiving publicity, I sought that authority from the Commission, which was given to me without qualification.

I told the Commission I did not know if I would be meeting with the Counsel for the President's Office or if I would be meeting with colleagues of the National Security Council.

No meetings subsequent to that authorization ever took place.

The second thing that I need to point out to you——

Senator D'AMATO. Are you saying you never met with the Council thereafter? Mr. Fielding or any of his representatives?

Mr. FEDDERS. Not in connection with this matter. Fred Fielding I consider a pal.

Senator D'AMATO. I understand. We're confining it to this meeting. There were no other discussions with you from Mr. Fielding or his office?

Mr. FEDDERS. I told you there was a second and I'm now going to call that to your attention. And you have these documents, in January of 1983, some few weeks ago, I received a letter from a gentleman by the name of Richard D. Rosenblatt, of Rancho Santa Fe, Calif.

His letter to me is dated January 20, 1983. Accompanying that letter is a letter that he had sent to Mr. William Clark on March 29, 1982, and another letter dated January 3, 1983.

He also attached to his January 20 letter to me a January 11, 1983 letter that he had received from Richard C. Morris, special assistant to Mr. Clark.

Mr. Rosenblatt was very concerned. He expressed that he was a graduate of West Point and that he was concerned about the characterization that Mr. Morris had put upon the termination of the SEC's complaint against Mr. Reed.

Mr. Rosenblatt asked me to give this matter my attention. I wrote two letters in response to that. On January 25, 1983, I wrote to Mr. Rosenblatt a short two-sentence letter thanking him for his letter and saying that I would discuss his letter and the accompanying documents with the appropriate persons within the Commission.

I call your attention now—I'm going to tell you about one of the documents. Mr. Rosenblatt was the gentleman who was on "60 Minutes" when that was published a week and-a-half ago, on the CBS network.

Second, it was the following night, also on CBS, that copies of these letters were prominently displayed to the national television audience.

The final thing that I did, after receiving Mr. Rosenblatt's letter, and as I said to him that I would do, I discussed it with Mr. Levine and Mr. Lynch. I telephoned Mr. Fielding and told him that I did not know Mr. Morris. I knew him, and that I was going to write him a letter clarifying what I thought could be certain misunderstandings.

I will read to you the second paragraph of my letter, which sort of summarizes the things that I said to Mr. Fielding. It is only five paragraphs, six paragraphs long.

In the second paragraph, I say, "There are several statements in Mr. Morris' January 11 letter which easily are susceptible to misunderstanding. The statements are in the second paragraph of that letter."

Then I set those forth. Now, in addition to that, having that conversation with Mr. Fielding, I do recall another conversation that occurred about a day or two later, when I either received a call from Mr. Fielding's secretary or Mr. Fielding's deputy, I don't recall which, asking where the letter was.

Given the dictation and the backlog in my office, it took a couple of days to get out. During that conversation this matter was addressed.

That represents the universe of my knowledge, and all of this has been called to the Commission's attention. Copies of these letters, this is not the first time that this is being made public, possibly, but within the universe of the Commission, certainly the activities that I've described have been well-known for a considerable period of time.

Senator RIEGLE. Let me, if I may, just go ahead then, on two other items here, at this point.

SETTLEMENT LANGUAGE TOUGHENED

The Commission authorized the staff to enter into a stipulation and agreement with Reed only after you toughened up the language of the settlement.

I'm wondering, why was the language stricken that read as follows: "The purchase of Amax options was made without any attempt at concealment, and was made in good faith"?

Why was that taken out?

Mr. SHAD. Because it mitigates the charge. It could be used as a contention of denial, and we didn't want to have any denial of the charge.

Senator RIEGLE. How did it get in in the first place?

Mr. SHAD. I guess the best source would be staff. But at the request of his attorney.

Senator RIEGLE. So that was then based on a request from Mr. Reed's attorney?

Mr. SHAD. Yes.

Mr. LEVINE. That's right.

Senator RIEGLE. Do you normally take statements like that from someone's attorney and put them in the document?

Mr. SHAD. This is staff negotiation, but it's negotiation. We come forward with what we believe are strong charges. They come back with their counter-proposals. And we end up with a negotiated document.

Senator RIEGLE. What was the staff's recommendation on this? Was it your recommendation to leave this in or take it out?

Mr. FEDDERS. It was the staff's recommendation to include the mitigating language. The Commission in fact toughened the settlement up.

There is no question about that. The Commission improved and toughened the settlement over the staff recommendation.

Senator D'AMATO. I think the question, if I might, Senator Riegle, more properly would go to the staff. I find it incredible, given the case, and I understand we have this little controversy or contention over what we call mitigating evidence that Mr. Reed might have.

I suggest that it's not worth too much, his testimony or the deposition of his father, and of his secretary, who stood to benefit by this, and of another friend of many years, that he intended to undertake this purchase 3 or 4 days before he made it.

I think he could have come up with something better than that. He certainly should have brought forth some better people than that to testify for him.

But the fact is, and I'd ask the staff now, the Senator touches on something which is, how was Mr. Reed or his attorney able to, in the initial stipulation which the Commission thereafter rejected, put in there that he did not attempt to cover up anything?

Why would you take that? How did that come about?

Mr. FEDDERS. I'll ask Mr. Lynch to address that, Senator.

Mr. LYNCH. First of all, I think we should note that the statement is a statement which is attributed solely to Mr. Reed. Unlike many of the provisions in the settlement it's not something that the staff stipulates to. It's just his representation.

Senator RIEGLE. So this is his language?

Mr. LYNCH. This is his language, that's right. It's his representation, and the language made it clear that the staff was not agreeing with his characterization of the conduct.

Senator D'AMATO. Are you saying that you didn't recommend acceptance, then?

Mr. LYNCH. No, we recommended acceptance of the language. But——

Senator RIEGLE. Why would you have done that?

Mr. LYNCH. The document itself did not suggest that the Commission or its staff agreed with the language. He was making his statement on the case, and the Commission was making its statement, and a very strong statement, I might add, by filing the complaint against Mr. Reed alleging fraudulent conduct in connection with his transactions in Amax securities.

Senator RIEGLE. It seems to me that what happened here, it must have been the Commission's judgment that there was concealment, because you knocked this statement out.

Is that a fair summary, Mr. Shad?

Mr. SHAD. Well, the circumstantial case we were bringing was on the contention that he had violated the law. So yes.

Senator RIEGLE. That was the judgment, then, of the Commission itself, was that there was a legal violation, and in fact, there had been concealment; isn't that the case?

Mr. FEDDERS. There is an analytical point.

Senator RIEGLE. I'm asking Mr. Shad first here, please.

Mr. SHAD. We had a strong circumstantial case, as I've said. Yet it wasn't a situation where you can say absolutely, that he had concealed or he had traded on insider information.

You couldn't say that. No honest man could make that flat statement.

Senator RIEGLE. We're talking about concealment. And you took the words concealment out, which meant that in your judgment, there had been concealment.

PARTIAL REMOVAL OF STATEMENT QUESTIONED

Mr. SHAD. The statement we took out was the statement "without concealment and in good faith," which he wanted in there.

Senator RIEGLE. That's right. And you took it out. So in your judgment, those were not fair characterizations.

Mr. SHAD. We just refused to accept it as part of the settlement. You know, we're negotiating and we say, "We won't accept that language."

Senator RIEGLE. Why was the word "fully" stricken from the sentence that said "cooperated fully" in reference to Reed's activities?

Why did the "fully" get taken out?

Mr. LYNCH. I think I can best answer that one. We went to the Commission. The Commission expressed a concern with some of the mitigating language. It was my recollection that there was some concern raised with the word "fully."

I went back to counsel——

Senator RIEGLE. Be more specific. What does that mean. Specifically, what was your concern about that?

Mr. LYNCH. There was concern raised with the phrase--let me refer to the documents--that he had acted in good faith. That he had not made any attempt at concealment. That he had cooperated fully.

There was a concern raised, to the best of my recollection, at the Commission table, with the word "fully," because there was some suggestion that he may not have cooperated fully, in fact, with the Commission.

Senator RIEGLE. That was the judgment, I guess, in the end, of all of you, was that he had not cooperated fully.

Mr. LYNCH. I think that's a fair characterization of my judgment.

Senator D'AMATO. Don't be afraid to admit it. It's a pretty obvious thing.

Mr. LEVINE. Senator Riegle, may I add something, just so the record is clear——

Senator D'AMATO. I've never seen such recalcitrance. Are you all afraid of Reed?

Mr. LEVINE. Senator D'Amato, in my job, I try to be fair with every person.

Senator D'AMATO. Let me go to the question. How consistent was this settlement with other cases' consistency?

In other words, if somebody else had come in and had this same situation, would you ever say to them, "He's going to put in there some language disclaiming any attempt to cover up," et cetera?

What would the staff have done? Have you ever taken, or consistently, is it a consistent practice for the staff to take a statement and include it in there, by that person whom you're bringing an action against, that would say that he did not attempt to cover up anything?

Mr. LEVINE. Senator D'Amato, in almost all our cases, counsel tries to get into the case mitigating language because they have to worry about the effect of that in private litigation and otherwise.

The Commission, in a lot of cases, determines not to approve or authorize us to accept the mitigating language. This is not unique, by any means. And it goes on on a day-to-day basis.

I'd like to simply point out what we said. What Mr. Reed wanted to state was simply that purchases were made without any attempt at concealment. That's all he wanted to say.

And that was the focal point of it. I wanted to make that clear for the record. The judgment of the staff is what is the best you can get? Does it serve your interests? And the litigation risks involved?

Should we get the settlement? When you charge the person with fraud, do you get the money back to the people? You don't litigate the case, and you have a prohibition of future violations.

We got all of that. And I simply say as you're having the reaction today, if someone says, "Hey, I tried to put mitigation in," how is it viewed?

It's viewed in that context. In my view, if we get the case resolved and get on with our business, it is an appropriate resolution.

However, the Commission felt it did reflect on the question of whether it was a denial. The Commission thereby determined to take it out.

They're my client. I abide by them. We negotiated. They reacted. That's all.

Mr. SHAD. Chairman D'Amato.

Senator D'AMATO. Don't be apologetic for taking that statement out, Commissioner. I think the Commission, if anything, should say "We took it out because we could not go along in good conscience with someone saying: I have cooperated fully and I didn't attempt to conceal facts, when the facts show definitely that he attempted to conceal."

Do you mean to tell me putting options in someone's name and making those kinds of phone calls, and signing people's names was not an obvious attempt to conceal?

Of course. Be proud of what you did. You did the right thing.

Mr. SHAD. Please. I'm not making any apology.

Senator D'AMATO. But it almost seems that way, Mr. Commissioner. We're good friends. I want to say to you, you show wonderful charity. You're being very temperate in your remarks. But the charity is out of balance here.

The Commission rejected that statement. It's obvious. The Commission changed the language, rejected a finding that he cooperated fully, and that he did not attempt to conceal things.

In so doing, the action speaks for itself. We know where Mr. Reed is. We know how he is there. We need make no apology for that.

Thank God, the Commission did what it did. Mr. Proxmire here would stand second to none in calling the tune the way it is, and revealing those situations that have to be revealed.

I don't think you want to have him saying "Don't be apologetic for the right thing that you did."

I think this would be entirely different if we saw you reversing the situation. Then you would be on the pan. Let me just suggest when you do something that's right, be proud about it.

Yes, there are going to be some people unhappy with me by making these statements. I know it.

Mr. SHAD. I appreciate what you're saying, but I think you misinterpreted my reason for asking.

Senator D'AMATO. You're a gentleman, that's why.

Mr. SHAD. I was calling for your attention because Commissioner Longstreth is very interested in responding to some of the views that are being expressed on behalf of the Commission.

I think he would like to express what transpired at that Commission meeting as he saw it, what he felt the issues were.

I wasn't being apologetic at all.

Senator D'AMATO. You're being very reserved. But inasmuch as Senator Riegle had some questions with respect to the Commissioners and their negotiations or their thoughts in regard to why they took this language out, and how they arrived at it, their final determination; why don't we ask all the Commissioners, if they wish, and more appropriately have them come forth and testify in regard to this?

If you think that's worthwhile, Senator Riegle. I think that could be helpful. I didn't know there were other Commissioners here.

I wondered, as they're coming up, I just want to say this, I think the question of whether Mr. Reed cooperated fully bears directly on his fitness to serve today in any capacity in this Government, let alone one of the top security positions in this Government.

He has the highest security classification that one can get, in terms of the enormously powerful position that he holds this very minute.

And if he cooperated less than fully, I think that bears very importantly on the issue of fitness to serve.

And the reason you want to get to the bottom of this is you obviously made a judgment as a Commission that he had not cooperated fully.

That language was in the draft report. You took it out. And I think we need to understand precisely why you took it out.

Senator D'AMATO. Let me swear in the Commissioners.

[Witnesses sworn.]

Senator D'AMATO. I'd like to again, at this time, indicate that Senator Riegle came in just shortly after we started.

Initially, I indicated to this committee, to the Commissioners, that in the absence of the facts that I was not aware of after having reviewed the file and after having had our counsel speak to counsel and various members of the Commission with regard to the

facts, that I would find it hard to believe that we should countenance the continuance of Mr. Reed.

He does a great disservice to the President and to this country in that capacity.

I certainly have not heard anything today at this point that would dissuade me from that feeling.

Now, here are three Commissioners.

Bevis, we'll let you go in any order you'd like to speak to the question of how you perceive this, what your thoughts were, and the recommendation that came, why the language was changed, or any other area you think is important.

Please go ahead.

Mr. LONGSTRETH. Senator Riegle was addressing questions to the staff as to what went on in the minds of the Commission. And I felt that under the best evidence rule, since we're here, we might be able to answer that as best we can.

Senator D'AMATO. Absolutely.

Mr. LONGSTRETH. I'd just like to make several observations about this case.

LITIGATION RISK

When it came before us, it was clear that there was a serious risk—litigation risk, as the staff said—that is, a risk under the existing law that we would lose the case.

If there was a case involving a tippee, an alleged tippee, trading in options and there wasn't a clear legal theory, an established legal theory, on which we could have proved that that tippee had violated 10b–5—as you heard from Chairman Shad, the general counsel's office, which did a memorandum to contribute to the discussion, at the Commission table, advanced some theories. But there was a district court case specifically holding that 10b–5 wasn't violated when a person using inside information bought or sold options, as opposed to buying the stock underlying those options.

So, we had a problem initially, as a legal matter.

Senator D'AMATO. On that point, may I ask you, it is a district court case—I was given to believe—was that case eventually affirmed by the U.S. Supreme Court? Is that the *Chiarella* case?

Mr. LONGSTRETH. It's not the *Chiarella* case. It was, I think, *General Dynamics.*

Mr. FEDDERS. *Laventhal* v. *General Dynamics* is the case, Commissioner Longstreth is addressing.

Senator D'AMATO. So, it's a district court case and not a Supreme Court case?

Mr. FEDDERS. I believe it is.

And it's a district court case from the Eastern District of Missouri.

Mr. LONGSTRETH. So, the case had problems in terms of our ability to win on a legal ground, however technical a legal ground, which the staff took into account in bringing the case to us and also in settlement, because you weigh the prospects of winning a case or losing it when you negotiate over a settlement.

But beyond that, we had two problems I just want to emphasize here with this case.

One was, as you've heard, it was all circumstantial evidence.

Although you could question the credibility of the father, the secretary, and the business associates, there was nothing on the other side except what he did. So, there was a problem there.

Senator RIEGLE. And the fact that he had never traded in options before is a pretty powerful case.

Mr. LONGSTRETH. He had traded in options a month before, and he had been an investor.

Senator RIEGLE. He had no previous history of trading in options before the Amax transaction. That, by itself, I think is a fairly startling fact.

Mr. LONGSTRETH. We weighed that.

I'm just trying to give you a little background.

The staff, I think—and here I'm talking about what was in the staff's mind—but as I understand the way we behave and the way the staff behaves in response, we were not seeking to establish far-reaching new legal principles.

We were trying to deal with this case—if we thought Mr. Reed had used a tip to make this kind of money, we wanted to go after him. We did believe that. And we did go after him.

But we wanted to be effective, rather than run the risk of getting into court and losing on a very important principle, which was that there can be a violation of 10b-5 in options.

So, we also had the problem—and I just want to mention this last thing—we had the problem of the credibility of the witnesses. They appeared—the way they testified, we were told they appeared to be solid and they would make a good impression before the jury.

The other problem is motive. It does seem peculiar for a person of Mr. Reed's wealth to be taking the kinds of risks—he's former Secretary of, I think, the Air Force—to be taking these kinds of risks for this kind of money. Four-hundred-twenty-four thousand dollars is a lot. But he has great wealth.

So, all these things I remember as being factors that were presented to the table.

Now, we went forward with the case. And when we got the proposed settlement, I think it reflected the staff's best judgment as to what it could do, get the best settlement and not run the risk of going to litigation.

Senator RIEGLE. Let me just stop you there.

It's interesting that you make the comment about his net worth, because we don't know his net worth. He's currently classified in the White House listing that puts him at one notch below where he need make a financial disclosure.

So, there is no financial disclosure that we can look at, unless you know something we don't know.

But I want you to comment directly on the fully cooperative language.

Mr. LONGSTRETH. I'm coming to that.

Senator RIEGLE. I know you are. But I guess I want you to get there.

Because you apparently made the judgment——

Mr. LONGSTRETH. I'm right there. [Laughter.]

Senator RIEGLE. That's what I want you to shed some light on.

Mr. LONGSTRETH. This is based upon my notes at the meeting, my doodles.

This is what we've got.

It's also based on John Fedders' memo which he referred to, which I think you'll find extremely revealing, because it laid out the policy that we started to articulate as a new Commission—two of us were new, very new.

Barbara was somewhat new. John has been around for a long time. But the three of us were relatively new, working together on a case here that was all circumstantial.

We asked that the attempt at concealment and the good-faith language and the fully—although I'm not as clear about my recollection about the fully—be taken out of this order, because we insisted that this order in no way prejudice the opportunity of a private plaintiff to "prove scienter, which means willful misconduct.

We wanted to be absolutely sure that in no way would this settlement provide Mr. Reed with an argument in a private case that would enable him to defend against that private plaintiff.

The reason we cared about that, aside from the fact it seemed right that our orders not be used against plaintiffs, investors who we were in the business of protecting, but also because we were getting the disgorgement for those plaintiffs, and we wanted to be sure they could reach the money.

So, we took that language out and any other language in here that in any way would have hurt a private plaintiff investor from coming forward and arguing his case against Reed and collecting the dough.

That's why we took it out. We didn't care about the admit or deny, as long as neither were in there or both were in there. We didn't want it just onesided.

We tightened this up in a couple of other respects, and started to establish a tougher practice in our treatment of insider trading cases than had been the consistent practice in the past.

In those respects, I think I ought to underscore them, because I'm very, personally—and I think the Commission is—proud of the policies we've developed.

One was that we would try, in every case we could, to settle only on the basis of 100 cents on the dollar of disgorgement.

Disgorgement is a pathetic remedy, but it's all we've got until you gentlemen and ladies help us with some better remedies.

But we at least ought to get 100 cents on the dollar, and that ought to be gross. It ought not to be net of somebody's taxes.

So, those principles we tried to establish here. And in John Fedder's memo, you'll see that he set forth that principle.

FIRST PURCHASE OF OPTIONS NOT CHALLENGED

Senator RIEGLE. Am I not right in thinking that he made the $315,000 the first time round on the options, and he's kept that?

Mr. LONGSTRETH. We didn't go after him on that.

Senator RIEGLE. I understand that.

But the fact is he made $315,000 earlier in this chain of events and presumably has it today.

Mr. LONGSTRETH. I don't know.

Senator RIEGLE. The point is it was not disgorged.

Mr. LONGSTRETH. But we can only get disgorgement of——

Senator RIEGLE. I understand what you're saying.

But there are several chapters to this play. The fact is you did not go after the earlier money. And I would not want the record to suggest that the amount that you got was all that there was to take a look at.

There was $315,000 that was made earlier on that you did not challenge and go after that presumably he has to this day.

Mr. FEDDERS. Senator, may I address that, because I think it's very important.

There were two earlier transactions when Mr. Reed purchased options. The staff investigation was aggressive with regard to both of those.

But the integrity of Government law enforcement requires proof, and the staff made the conclusion that it did not have proof that there was material information available to him at the time that was inside information.

And the integrity of the Commission is solid behind that. It was reviewed carefully. There was no evidence. There was no proof. Consequently, there was no charge.

Senator RIEGLE. I hear you saying that, and I'm not surprised that you would say that and that that's your belief.

What I'm saying is that when I see the emphasis given to the fact that the money that was generated on the second set of transactions—he had to cough it up, and you insisted that he cough it up, and that somehow that sort of cleans the record—it doesn't leave a good taste in my mouth when I think there's just as strong a reason to believe that the pattern of activity here was probably there from start to finish.

And as a matter of fact, he made $315,000 at another point, and nobody has touched that.

Mr. SHAD. There's a big difference, of course, in the facts between the two transactions, a very large difference.

Senator RIEGLE. That may very well be.

But I think it really strains the imagination to think that the chain of events, the pattern of activity here in the relatively short space of time, the same stock, he's never been in options before, he comes in and he makes a killing on two occasions, and that somehow these two events are totally separate.

I understand your argument here. I understand the point you're making.

Mr. SHAD. The first options that he bought, he paid $40,000 for, not $3,000—for options on the same number of shares.

Senator RIEGLE. How much did he make on those?

Mr. SHAD. They subsequently went from $40,000 in market—while he owned them, after he bought them—down to about $3,000 or $4,000, because the stock was dwindling, there was no news. Subsequently then, yes, he did make a $315,000 profit.

But I do think it's reaching to try to put the two transactions in the same box. They're different—quite different—in terms of the critical things that caused us to believe we had a sustainable case.

The difference was the timing of those conversations with his father and the purchases.

Senator RIEGLE. I hear what you're saying. But that's not to say that there may not have been, in fact, the same chain of events at work in the earlier transaction. You just don't know.

Mr. LONGSTRETH. And we couldn't prove it.

I'm sure you're not questioning our good faith.

Mr. SHAD. In the earlier transactions——

Senator D'AMATO. Now wait a minute. I'm the chairman here.

I think it's deteriorating into some argumentative areas that don't really add to the purpose of our hearing now.

Senator Proxmire—I have some questions, but Senator Proxmire has been sitting by very patiently. He has some questions.

We understand the nature of the first two acquisitions. Under the law, the feeling, the understanding, and the determination—and I don't question this—that there was not sufficient proof to undertake a case.

By the same token, I think it's reasonable to say, to conclude, that looking at the totality of the acquisitions, the fact that heretofore Mr. Reed had never purchased options, that it really would lead us to believe—even though you may not have had the legal authority under the law to proceed—that it demonstrated a pattern, a rather systematic pattern in connection with this stock.

But it does not serve any useful purpose to pursue that course at this time.

Senator Proxmire.

Senator PROXMIRE. Chairman D'Amato earlier talked about whether or not this was consistent with other decisions.

And I just have one question with respect to that. Then, I have a couple of other brief ones.

FINAL SEC SETTLEMENT AGREEMENT

The final SEC settlement agreement which allowed Reed to continue to assert his innocence. I understand, however, that in most SEC settlements the accused is not required to acknowledge his wrongdoing, but is prohibited from asserting his innocence.

According to Mr. Reed's attorney—this is Michael Plishner—the settlement Reed got—and I quote—"certainly is unusual in my experience."

Why did the SEC deviate from its customary practice, Mr. Shad, in this case?

Mr. SHAD. I think his attorney's self-compliment of what he was able to negotiate is not an admission against his interests certainly.

Senator PROXMIRE. Was his attorney wrong? Is this common?

Mr. SHAD. I can cite a number of cases which it has not had the "without admitting or denying" language.

We can cite a number of cases in which were on similar grounds.

Senator PROXMIRE. In other words, it's not unusual for the defendant in this case to assert his innocence?

Mr. SHAD. Well, after the fact; he doesn't assert his innocence in the pleadings. He didn't deny any of the allegations in the order that we obtained with the court.

Senator PROXMIRE. Wasn't it a fact that he asserted his innocence after the fact so he could get that job at the White House?

Mr. SHAD. The problem that we've had with the language on more than one occasion, "without admitting or denying," is that people have subsequently denied it. He said he wouldn't do it publicly. What he said at the White House is not within the order.

Senator PROXMIRE. I'm sorry. Did you want to say something, Mr. Fedders?

Mr. FEDDERS. Senator, every settlement has some unique aspects. There's no question that there are some aspects of this settlement that are unique.

During the settlement negotiations, the counsel that you mentioned, in intensively negotiating the language, when it was agreed—where the words "admitting and denying" would not be included, there was a representation made to Mr. Lynch that there would be no denial.

And we consider the denial that has been made by counsel to be a breach of settlement negotiations.

Senator PROXMIRE. There was another rather disturbing statement that was made that reminded me of something that happened 7 or 8 years ago, when you talked about erasing tapes.

Do you automatically erase tapes after 30 days? This wasn't unusual, and I'm sure it wasn't. But why do you do that?

Here we are in a technological age, when you have microfilms that can keep all kinds of useless information alive forever. But you gentlemen I think underestimate the great importance of your deliberations. I would think you'd use microfilm. The cost would be rather small. It would be available for occasions like this so we could know exactly what did take place.

Mr. SHAD. The use of the tapes—the evolution of the use of the tapes at the Commission was simply to facilitate the preparation of the minutes by the Secretary after the meeting. There is no legal requirement that we have them at all. And we have a limited supply on a tight budget, so we erase them and rerecord over again on them, time and time again.

Senator D'AMATO. We're going to give you enough money in your budget so you don't have to do that. [Laughter.]

Senator PROXMIRE. Now, Mr. Shad, the one specific concrete, clear violation, fraud, it seems, that Mr. Reed engaged in was the forged signatures on applications for option accounts. He also falsified information on these applications and backdated the applications.

All these would appear to be violations per se of securities law. Why didn't the SEC bring action in those specific cases?

Mr. SHAD. I asked that same question. And I learned to my surprise, forgery is not within the securities laws. The fact that he forged signatures does not fall——

Senator PROXMIRE. You're the SEC Commissioner. I'd feel much better, though I have great admiration for you, and you didn't realize that forgery was not within—it should be in your law; shouldn't it?

How about making a recommendation to us so we can put that in the D'Amato bill and the Proxmire bill? [Laughter.]

Mr. GOELZER. It's not in itself a violation of securities laws.

Senator D'AMATO. Would you comment on one other aspect as you comment on that: 10(b)(5) on the options. I think we have a good start on a bill, you know. Treble damages, increased criminal penalties. But I'd also like to deal with that district court decision that is predicated upon some logic in a Supreme Court case, and close that loophole.

Because I think if there's anything that can provide an even greater opportunity for profit, et cetera, it's by the use of options.

So, we don't have a case like this where we're afraid and it becomes a difficult case.

Senator PROXMIRE. Mr. Chairman. Before the witness responds, we have nine witnesses at the table, but you're the only mystery man.

We have yet to hear what your name is.

Mr. GOELZER. My name is Dan Goelzer, I am the Commission's General Counsel.

With respect to your second point, Senator, there has been a subsequent district court decision involving these very transactions in which Mr. Reed is a defendant: *O'Connor & Associates* v. *Dean Witter Reynolds & Associates* which in essence confirmed one of the theories that the General Counsel's Office had offered in support of this case at the time the Commission considered it.

So, we're optimistic that with or without legislation, we can sustain the theory that insider trading involving options is a violation of rule 10b-5. The Commission has certainly brought a number of cases involving options.

Senator D'AMATO. What about some clarifying language, though, in addition. Do you have any suggested language you could develop.

Mr. GOELZER. I can only say that we're considering that now in connection with the Insider Trading Sanctions Act.

Senator D'AMATO. That bill's going in tomorrow, and I'd like your response to this by way of some legislative suggestions.

We can always amend it by seeing to it that we don't have the problem of, conflicting case law. In one district court case, they found we couldn't go after them. In another one, we did.

So we'll resolve that. And I'll leave that to you. Please respond to Senator Proxmire.

Mr. GOELZER. We will consider that, Senator. Let me just say that the Supreme Court is also considering another strand of this in the *Dirks* case.

We had thought that we would see what clarification they give to the law in this area in connection with making a recommendation.

The only point I wanted to make with respect to what may have been forged documents in this case, would have been evidence that we would have used as part of our case or insider trading.

It wasn't something that was looked at independently. There certainly are circumstances, some of the accounting provisions of the Foreign Corrupt Practices Act would be one, where falsifying documents might in itself be a violation of the securities law.

Senator PROXMIRE. But you didn't really consider taking any other action, even though you say it would have been a violation of the Corrupt Practices Act?

Mr. GOELZER. In this case, I don't believe it would.

Senator PROXMIRE. It would not have applied in this case?

Mr. GOELZER. It would not have in this case. I was trying to make the point that in some cases, the falsification of documents would violate the securities laws.

Senator PROXMIRE. I have one other question. This relates to the White House misrepresenting the SEC case. Mr. Fedders has dealt with this to some extent, in discussing the Rosenblatt letter.

Now, Mr. Fedders, on January 11, 1983, that's this year, 2½ months ago, Richard Morris, Special Assistant of the National Security Adviser, William Clark, wrote in a letter that the charges against Mr. Reed, and I quote, were "fully investigated by the SEC. And after an investigation and the taking of depositions of all concerned parties and agencies, the charges were dismissed; notwithstanding the rather damning circumstantial evidence."

Would you call that a true statement about what really happened? Were the charges against Mr. Reed dismissed?

CHARGES SUSCEPTIBLE TO MISUNDERSTANDING

Mr. FEDDERS. They were not dismissed, Senator Proxmire, and I responded, as I told you before by writing to Mr. Fred Fielding, Counsel to the President, on January 26, saying the statements in Mr. Morris' January 11 letter were easily susceptible to misunderstanding.

I then went on in the following paragraph——

Senator PROXMIRE. Wait a minute. You said easily susceptible to misunderstanding. It seems to me they're just flat wrong. Inaccurate, untruthful. Well, I'd say a lie. Sure. After all, that's what this is.

Investigated and dismissed. He says dismissed.

Mr. FEDDERS. Senator, the caption on the document that did dispose of this, the caption reads, "Stipulation, termination, dismissal, and order."

The reason those words were selected and agreed to by the staff is that upon the filing of the complaint, and the entry of the order, the entry of a stipulation, the case was terminated and dismissed.

It was dismissed, though, by the Commission receiving, first, a court order, and second, full disgorgement as we sought in the complaint.

Senator PROXMIRE. He said the charges were dismissed.

Mr. FEDDERS. I did not say that.

Senator PROXMIRE. He says that, and you say that's flatly wrong.

Mr. FEDDERS. I say that that's incorrect.

Senator D'AMATO. It's not true?

Mr. FEDDERS. It's incorrect, and not true. I believe they mean the same thing, yes.

Senator D'AMATO. It's important because it's just not true, and I just called Senator Proxmire's attention, before he asked that question—I have a letter. NT stands for "not true." It's just not true.

Mr. SHAD. It's not true, but it is susceptible to misunderstanding when you see in the caption itself the word "dismissal."

Senator PROXMIRE. You can say that about any lie, that it's susceptible to misunderstanding.

Mr. LEVINE. The parties didn't have that misunderstanding, and the last sentence in the stipulation says that the parties agreed this action is terminated and the Court shall retain jurisdiction to effect compliance within the terms of the issuance of the order.

It's clear that we knew, and they knew what was happening. That this was resolving the matter. And dismissal, what John was trying to clarify, was that this was—someone may have understood that the case was dropped. It wasn't. It was resolved, and the order was enforceable so there wouldn't be future violations.

Senator PROXMIRE. Mr. Chairman, I'm going to have to leave. But before I leave, I want to again congratulate you on holding this hearing.

Second, I think you've done a remarkably good job. I think you've done a first class job. And I'm very, very impressed by the vigor and fairness with which you've gone after this.

You're a Republican. I'm sure you're proud of that. I'm aware of it. Nobody's perfect. [Laughter.]

I must say that you've handled this very well. I know there are areas where I think the SEC, all of us might feel, should do differently, but I think that it's still a great agency and I'm glad there are such outstandingly fine people in charge.

Mr. SHAD. I share your high regard for the agency and the staff that did this job. They were first rate. And my fellow Commissioners.

So we did take strong exception to the implication that we acted improperly, and we appreciate this opportunity to respond to any questions.

Senator D'AMATO. I would like to, before giving Senator Riegle an opportunity, to ask you, you have several more questions?

Senator RIEGLE. A few more.

MEETING WITH SPECIAL ASSISTANT, NSA

Senator D'AMATO. Turn to this question of Mr. Morris. How many times did Mr. Morris meet with staff or members of the Commission in regard to the review of this matter?

Mr. FEDDERS. On one occasion, Senator.

Mr. SHAD. He never met with the Commissioners. Only with the staff.

Senator D'AMATO. On one occasion. Were the files made available to him on that occasion?

Mr. FEDDERS. I'll ask Mr. Lynch to address that.

Senator D'AMATO. Could you explain to this committee, what the circumstances were. How much time was spent, what information was asked for, were there any followups? Were there any other communications, et cetera?

Mr. LYNCH. My recollection of the events—they were some time ago, now. But my recollection of the events is that Duane Cheek received a call from Mr. Morris, asking to meet with the staff and discuss the Reed matter.

Duane informed me of the conversation, and I informed Ted Levine of the conversation, and we all decided to meet with Mr. Morris.

We also asked Susan Pecaro, who is a staff attorney in the division, to sit in the meeting with us. The meeting was a relatively short meeting, to the best of my recollection, lasting perhaps 20 minutes to 30 minutes.

There was the initial contact to set up the meeting, then there was perhaps a call back to confirm that there would be a meeting, and then a meeting.

And as far as I know, there were no further conversations with Mr. Morris following the meeting.

Senator D'AMATO. What information did you give him? How long did the meeting take?

Mr. LYNCH. The meeting lasted, I would say——

Senator D'AMATO. I see some notes here. June 15, 1982, from the file.

Mr. LYNCH. These are the notes that Ted Levine discussed a little earlier.

Senator D'AMATO. Would you go into that meeting, please?

Mr. LYNCH. I'll go into it, to the best of my recollection. The meeting lasted approximately 20 to 30 minutes. It took place in Mr. Levine's office. The four staff members that I previously identified sat in. Mr. Morris was unaccompanied.

He started out the meeting by saying that he had reviewed the matter, and he made specific reference to the transcripts of the testimony of Mr. Reed.

It seemed that the primary focus of his questioning was whether or not Mr. Reed was a perjurer, whether he had lied to the Commission.

Senator D'AMATO. Did he ask you that?

Mr. LYNCH. He put the question to the staff. That's correct.

Senator D'AMATO. Did you respond?

Mr. LYNCH. Mr. Levine gave the response that he testified about earlier.

Senator D'AMATO. Were you asked?

Mr. LYNCH. I was not specifically asked the question, no.

Senator D'AMATO. Did you offer a judgment?

Mr. LYNCH. I did not offer a judgment.

Senator D'AMATO. Was anyone else asked?

Mr. LYNCH. It's my recollection the staff was asked. Mr. Levine responded on behalf of the staff.

Senator D'AMATO. And you're saying the essence of this 20- to 30-minute meeting with Mr. Morris was basically to ask you whether or not Mr. Reed was a perjurer?

Mr. LYNCH. He asked that question, then he also asked a question as to whether or not we had a judgment as to whether his character was such that he should have a position involving the national interest.

Senator D'AMATO. Did he review the facts of the case with respect—did he ask you about the purchase of the options, the phone calls that were transmitted, the forgeries, the documents that were placed in other people's names, or any of that?

Did you go into that?

Mr. LYNCH. I have a vague recollection that we may have discussed the phone calls with the father. We referred him to our complaint, which he had, where we pointed out that the Commis-

sion had made allegations, that the staff attorneys had signed the complaint making these allegations, and we believed that we could establish them by the preponderance of the evidence.

Senator D'AMATO. Let me ask you, did he ask you for the file? Did he have a complete copy of all of the documents?

Mr. LYNCH. I don't have a recollection of him asking us for the files.

Senator D'AMATO. Did anyone make available to him the file?

Mr. LYNCH. I have no specific recollection of any discussion with regard to whether our files were made available, whether he requested it, or whether we offered.

Senator D'AMATO. Mr. Levine, were the files made available to him? You would know that, wouldn't you?

Mr. LEVINE. I don't think the files were made available, Senator D'Amato.

Senator D'AMATO. He did not ask, did he?

Mr. LEVINE. He did not ask. Our normal practice, if any governmental agency asks for our files, is to turn them over. And we were not asked for it.

Senator D'AMATO. I'm not impinging——

Mr. LEVINE. I'm not trying to be defensive. I had a sense he had the transcripts, and he knew the facts. So there's no misunderstanding.

Senator D'AMATO. So any transcripts that he would have had——

Mr. LEVINE. Transcripts of Mr. Reed, which sets out the facts. Plus he had our own complaint, which set out the other allegations on the other side.

So, at least it's my sense, he was familiar with the facts of the case. He got to read transcripts, I believe, from Mr. Reed's attorney. I presume that.

He didn't specifically tell us, but he had the transcripts. He didn't get them from us; but he already had them. Or at least, he had access to them, because he had read them.

Mr. LYNCH. He also made reference to Mr. Reed's father's testimony, and the fact that the father had denied transmitting any nonpublic information to his son.

We certainly had the impression that he had reviewed the facts in the case, and certainly had reviewed Mr. Reed's transcript.

Senator D'AMATO. The question is, Mr. Morris' letter responding to Mr. Rosenblatt, where he first said that the charges were dismissed, which obviously was not the case.

He then goes on to say that he does not confess to the entry of any decree.

Do you think that's a fair characterization, that this is a decree or a settlement?

Mr. FEDDERS. It's an order, and as I said before, I believe the words that Mr. Morris used were "easily susceptible to misunderstanding."

Senator D'AMATO. Then he goes on to say he had no beneficial interest in the profits made. How would you characterize that? Would that be completely truthful and candid?

Mr. FEDDERS. It's certainly confusing.

Senator D'AMATO. "Purchased them for the benefit of other persons: employees, associates, and family members," it went on to say.

Oh, and the $432,000 was transferred in trust for designated charitable and other purposes.

Those other purposes, of course, were to satisfy pending litigation. Is that correct? In the event that it was successful, by others who may have suffered losses?

By the way, others did suffer losses as a result of this; is that not correct? Somebody lost money. Someone made it and someone lost it?

PRIVATE CIVIL LITIGATION INITIATED

Mr. FEDDERS. These being options, that is true, Senator. There was a private civil litigation initiated, which Mr. Goelzer alluded to, where a plaintiff, alleging that he had been defrauded in a transaction, initiated private civil litigation.

Senator D'AMATO. What was the outcome of that?

Mr. FEDDERS. The private civil litigation remains pending.

Senator D'AMATO. It's still pending?

Mr. GOELZER. The case is not being tried. The decision I referred to was on a motion to dismiss the action. That was rejected.

My understanding is the case is in trial.

Mr. FEDDERS. It has not yet gone to trial. It's still in discovery, apparently.

Senator D'AMATO. Let me, before I conclude my questioning, say that it's unfortunate that the SEC came under this cloud.

There were some newspaper articles that I think were terribly unfair. "Reed investigation engulfs SEC and Congress in blamefixing."

Let me suggest that first, no one from the SEC asked this Senator, or to my knowledge, any other Senator, to call a hearing.

Second, contrary to Mr. Tyler's information in the Post yesterday, that there's some kind of dispute between the Senate committee, the Oversight Committee, and the House Oversight Committee, nothing could be further from the truth.

We certainly intend to cooperate in every manner, as I know the SEC has cooperated with us. As a matter of fact, I called to advise Congressman Dingell to ascertain whether or not he would have any objection.

I sought his cooperation. He suggested a certain line of questioning, as a matter of fact, which precipitated us in our communication to the SEC, in addressing certain of those questions that you addressed your memo to, and your testimony to.

I think it would be a terrible disservice to imply in any way that this committee and the committee of the House of Representatives in any way have diverse interests and objectives in seeing to it that all of the facts are put forth.

I think in so doing, in examining in minute detail, as we've attempted to do today, the manner in which the settlement came forth, the process that was involved, the thinking and consideration that went into it, would amply demonstrate that the SEC, at least, did its job in a manner consistent with the law.

It also, I believe, demonstrates the need for legislative changes, in seeing to it that various areas of the law are tightened.

And as we've indicated, a bill will be submitted tomorrow that addresses some of those areas. I think we'll have to expand further.

As I've indicated, I don't believe we should leave the question up to an interpretation of one district court as opposed to another, but merely indicate that Congress has every indication of seeing to it that insider trading certainly will focus in on the use of options and that this is an area that we intend to see that the tippee is not often free. Because somebody loses when someone gains unjustly.

We forget that. Somehow the public may not have the sense of what takes place in this, so I would like to say that we have found, and I know that Senator Proxmire agrees with me, that the SEC has been fully cooperative in this matter

I think when we look into this, we see that there are others whose judgments may be questioned in regard to Mr. Reed, to his elevation, to his transactions.

But I don't think that anyone can possibly say that this was a matter of coincidence, even giving him the best of intentions, and the benefit of the doubt, as I think we should, since our jurisprudence system demands of us fair play.

I think it's incredulous and incredible for one to have to come to the conclusion that after never having traded options, he proceeds to do so, that the flows of information back and forth to his father, who is a board member, the placing of these options not in some charitable institution's name, is not right from the beginning, where they were purchased in that manner, and thereafter, when he was going to complete a sale, the soaring prices were such that he came to recognize that there would be deep difficulties, indeed, almost at a frenetic, frantic pace trying to find people, and when he couldn't find them, signs their names; it's inconceivable that anybody, or that Mr. Morris could affix his signature to these letters, in which he indicates that Mr. Reed is being victimized.

If anybody is being victimized, it's the American public and the Congress.

The fact that the good reputation and the hard-earned respect and hard work of the SEC and staff and the Commission would be impugned as a result of this fiasco— that's why I suggest to you, Mr. Shad, that you're being too charitable in not saying what the situation really was.

This conduct was improper, it was illicit, it was at variance with the truth, and he tried to cover it up. That's exactly what the facts indicate as far as this Senator is concerned.

Now, maybe I'll be involved in some kind of libel or slander suit, because I guess I'm not covered—am I?

Oh, that's wonderful. [Laughter.]

Senator D'AMATO. Senator Riegle.

Senator RIEGLE. Mr. Chairman, I might also just express a couple of thoughts along these lines myself.

Then, I want to address just two or three more questions.

I think what we've learned today—and the review of the record makes it clear—that Mr. Reed participated in improper and illegal conduct.

I think it's also clear that the improper conduct created a personal gain for himself and damaged innocent parties. He was compelled to surrender part of the improper gain, but there were also gains made in this series of transactions which he has kept.

INADEQUACIES IN SECURITY CLEARANCE PROCESS

After this took place, he was then given an administration within the White House at the highest possible level, dealing with the most sensitive classified information that's in the possession of our Government.

For some reason, it appears that there was not a full FBI field investigation conducted, which would have gotten deeply into these matters here that we've been discussing today.

It appears, also, that extraordinary procedures were used to expedite and circumvent normal security clearance procedures, or else there were just gross inadequacies in that security clearance process.

And the questions that we're discussing today with this kind of intensity should have been raised and should have been dealt with before this man was given this new position.

And now, with all of this brought to light, the position of the administration is to keep this person. He's on the Government payroll today and presumably will be for some weeks to come. I think that's wrong.

My hope would be, Mr. Chairman, that in light of the comments that you have made and Senator Proxmire, that if this individual remains in this position in the days ahead, I think it would be proper—and I think the right thing for this Committee to do—to ask Mr. Reed, himself, to come here and to also ask Mr. Clark to come here and to review in detail how it was that this chain of events evolved the way it did and that we have the situation that we find today.

I think these are questions that need to be answered. And I think if this person is going to continue to serve in this position of extraordinary sensitivity, that the rest of the answers have to be provided—that these witnesses cannot provide. They can only take us through the SEC part of the story.

They can't take us through the security clearance part. They can't take us through the thinking that was behind the letter that has been disputed here that was sent out by the assistant, by Mr. Richard Morris.

And so, I think those questions have to be answered, and I hope we can pursue this.

And I'll make a final comment on that at the end.

Mr. Fedders, you said earlier that denial is a breach of the settlement arrangement. You said it with some feeling.

I want to reconstruct your comment that you made about 25 minutes ago and what you made that in reference to.

Mr. FEDDERS. During the course of the settlement negotiations, Government lawyers and lawyers for private individuals have conversations that are frequently of the highest degree of confidence.

During the course of the settlement negotiations here, there were intensive negotiations with regard to the words "admitting or denying."

Staff made a concession. We admit that those words are not in here. We don't think that that's to the detriment of the public interest. We don't think it reflects adversely on the Commission.

We think we believe the words of certain district court opinions indicate that there can be a conclusion that there was an admission.

But my colleague, Mr. Lynch, received a commitment from Mr. Reed's counsel that subsequent to the conclusion of the court proceeding that there would be no denial. I believe that that agreement with my colleague has been breached.

Senator RIEGLE. I think that that's a very serious matter. In fact, I think it's one of the most important things to come to light today.

In the professional view of those of you who were charged with reaching this agreement that the agreement has been violated to that extent by a denial, notwithstanding these understandings that have been worked out before—it troubles me, because it seems to me to be part of a pattern of being less than fully honest all the way along, being less than fully cooperative, a pattern of activity that continues, it seems, even up to this time, that denial is being used in direct contradiction of the agreements that were entered into.

I just think that's inexcusable. The fact that it's being done by the legal counsel I attribute to the client himself. I think that's Mr. Reed's responsibility. And I can't separate himself from his counsel in this instance.

I think that's a breach of the integrity of the understanding. And I think it's improper. It's the most recent improper act that we've been able to verify—as of this afternoon's hearing.

I just, finally, want to say there are a couple of other loose ends here that I'm not completely satisfied about with respect to the SEC's action itself.

If my information is correct, the broker in the D.C. office of Dean Witter has not been contacted, even though he was the one who presumably received these documents that we now know were backdated and which have been falsely signed.

I am troubled about that, that you would not have talked with that broker.

Mr. FEDDERS. May we address that, Senator?

Senator RIEGLE. Yes, if you would.

Mr. FEDDERS. I'll ask Mr. Lynch to address that.

Mr. LYNCH. It's our understanding that the registered representative with Dean Witter in the Washington office merely acted as a clerk, that he received the documents and he forwarded them to California, that he knew nothing of Mr. Reed or anything about the transactions or about any of the other people involved, that he merely acted as a forwarder of documents. He had no supervisory responsibility over the account, nor was the account his account.

Senator RIEGLE. What about the broker in California? Why was no action brought against that broker?

Presumably, he was aware of what was going on here, that there was falsification going on.

Mr. LYNCH. We took the testimony of Larry Hayden, who was the broker in California. We examined him with regard to whether he had traded on inside information, because he also placed orders to place Amax options following the orders placed by Mr. Reed.

Based on the testimony he gave us, we could not say that material nonpublic information had been communicated to him.

Senator RIEGLE. Was he aware of the fact that documents had been backdated and falsely signed?

Mr. LYNCH. The backdated documents came from Washington. They came from the east coast.

The documents that were directly produced to him from the five beneficiairies, the reported beneficiaries of the purchases, were not backdated. They were dated properly.

Senator RIEGLE. So, you found no basis for action against him.

Have the records been cleaned up? Are the records in order today?

Mr. LYNCH. I really can't answer that question, Senator Riegle. I don't know the answer to that question.

We did not view——

Senator RIEGLE. Don't you have an obligation to see that that's done? In other words, don't you have an obligation to see that the falsification is corrected, that the documents, as of today, would be in proper form?

Mr. LEVINE. You're absolutely right. The broker has to keep accurate records.

In light of what's come to light, I'm sure we'll go back and check. But I'm sure the broker involved knows, now, the facts. And I don't think anyone at the broker would be misled.

Our judgment was—as you, I think, appropriately characterized it—was to focus on the insider trader aspects of this.

As Mr. Lynch said, of the eight people, five filled them out correctly. There were two from the east coast that were shipped out to the clerk there, where the problem occurred.

My judgment, as a matter of prosecutorial discretion, I would not recommend at this time to the Commission that we take action. But I'm certain we'll check—and to make sure that the records are correct—because I think they are certainly aware of the information given out.

Senator RIEGLE. I also think—though this is beyond the reach of our subcommittee to do this—but in light of the fact that Mr. Reed holds a position, and a classification status one notch below that, requiring a financial disclosure, which I question, that looks to me like that may be an evasive device.

Senator D'AMATO. It certainly was.

Senator RIEGLE. I would like to urge to the administration to ask Mr. Reed to make a disclosure. I think it would be a healthy development all the way around. And I would hope they would see fit to do that.

Mr. Chairman, I just want to say that I, too, want to commend you for your initiative in calling this hearing and attempting to uncover the facts here and lay them out. I hope that unless we see action taken very quickly here on this matter that we would pursue it. I think we ought to.

I think Mr. Reed and also Mr. Clark ought to be asked to come in and address this issue, or this matter is just going to hang fire for several more weeks.

I, finally, want to say, to the staff members and to the Commission members that are here, I appreciate the presence of all of you. I think your presence and the intensity with which you present your thoughts and background information on this indicates clearly your concern about it, your feeling about it, the seriousness with which you take your duties and your responsibilities.

I think, in the normal course of events, we might not have seen all of you here. The fact that you're here I think is a positive showing of a full effort on your part to address the concerns that exist here.

And I think the responses have been helpful to us. And I want to take those and talk with the chairman and see where we go from there.

Thank you.

Senator D'AMATO. Commissioner Evans.

Mr. EVANS. Mr. Chairman, Senator Riegle is absolutely correct. In the normal course of events, neither Commissioner Thomas, Commissioner Longstreth, and I would have not been here. We had other commitments and would not have been here except for our strong feeling with respect to this matter.

COMMISSION HAS NO REASONS FOR APOLOGIES

I'd like to just say—if I could take just a minute or two at this time—that, in my view, the Commission has no reason whatsoever to be apologetic about its actions in this case. I admit it's a circumstantial case. And I think we have been as fair as we could be to those who were charged in the injunctive action that we brought.

There may well be additional charges that could have been brought. But the Commission does not bring charges against individuals unless we believe that we can prove the charges by the necessary standards in a court. That's what we did here.

Senator D'AMATO. Obviously, you're saying that you felt you had the necessary information to sustain charges and that you therefore went forward and accomplished what you would have had it been a litigation—no more, no less.

Mr. EVANS. That's correct.

Mr. SHAD. Very well said. That's exactly right.

Mr. EVANS. If we had believed the testimony of Mr. Reed, we would not have brought this case. That seems to have been a very difficult answer to get from the group today. We only bring cases where we believe we can sustain the charges. I think it's important that we make that very clear here today. We have been as careful as we could not to improperly impugn anyone's motives. But the fact is we would not have brought the case had we believed Mr. Reed's testimony.

Second, I believe that the staff has done a workman-like, professional job, and they have acted with complete propriety in what they did in working out the settlement. The Commission strengthened the settlement, but just marginally. The changes that we re-

quested were not all that significant, actually, as far as the final settlement was concerned.

I'd just like to add that I'm very proud of the job our staff did. I am proud of the job the Commission did. And I don't believe these hearings should close without being made perfectly clear, that we are not apologetic for our actions in this case. I'm not apologetic for our actions, and I think the others are not apologetic either.

Senator D'AMATO. Commissoner Thomas.

Ms. THOMAS. I would like to echo the sentiments expressed by both Commissioner Evans and Commissioner Longstreth and say one thing that you started to say, Senator D'Amato—and said well.

We have here a case where the Commission's sanctions were not nearly sufficient. The SEC needs to have broader sanctions with respect to insider trading. We need another weapon in our arsenal.

We have drafted and submitted to you legislation that we think is simple and clear and effective and that will, we hope, be passed by this august body and by the other House. The legislation will enable us to treat the problem at the beginning, to have a meaningful deterrent, by inducing a potential insider trader to think before he acts—to have him think, "Aha, it will cost me three times my illegal profit if I go into this illegal transaction,"—rather than providing him with the comfort that the best that the SEC can do under the circumstances is to get disgorgement of his profit.

Under the present circumstances, disgorgement leaves the wrongdoer in no worse a position than an honest person who refuses to act.

We need to have a simple remedy. We need treble damages. We need the right to make this a more costly crime to engage in than it is.

And we thank you for your support of our legislation.

Senator RIEGLE. It sounds like you need more staff help, took, from the stories I've been reading.

Ms. THOMAS. I certainly agree with that.

Senator RIEGLE. Being starved at the budget level is another way to really circumvent these laws. As weak as the laws are, if you don't have sufficient staff to go out and track these things down, that's another way to defeat the law as it stands.

BEEF-UP BUDGET REQUEST FOR SEC

I would hope that we could see a beef-up in the budget request for enforcement activity for the SEC. I think it's needed, and I think it ought to be supported.

Senator D'AMATO. I share the Senator's concern.

As a matter of fact, as you know, this committee will be meeting Friday morning. And Chairman Shad and others will be here to testify with respect to the SEC reauthorization.

And I would hope that with respect to any questions in terms of the necessary staffing, that we would have a full and frank presentation by the Commission—not by the Commission via OMB or the other way around.

And I would only, again, like to conclude by thanking you for your participation, indicating to you that the intensity of the questioning, I believe, was very necessary.

I think it's important that we demonstrate to the public that this is not just that we're good friends and we all go around and protect each other, but that we're going to get all of these facts right out into the open—unpleasant as they may be.

Otherwise, we impugn your efforts, the efforts of the Commission.

And in the minds of the public, the big people, people with clout, people with money, get away and do whatever they will. That is not the case. There may be others who are now required to go forward, so that we can keep the confidence of the American public.

Thank you very much.

This committee stands in recess.

[Whereupon, at 3:30 p.m., the hearing was adjourned.]

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